No. 87-256

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

CHARLES S. CHRISTENSEN and JENNE CHRISTENSEN, JOINT TENANTS; ALTIE L. CLARK and LENA F. CLARK, JOINT TENANTS; JOHN C. ECHON, INDIVIDUALLY AND AS JOINT TENANT WITH LILLIAN ECHON; JAMES M. HOSS, JR. and MARIAN C. HOSS, JOINT TENANTS; HENRY B. HOSS; DAVID C. KRISER and PENNSYLVANIA NATIONAL MUTUAL CASUALTY INSURANCE COMPANY,

Petitioners,

—against—

KIEWIT-MURDOCK INVESTMENT CORPORATION, PETER KIEWIT SONS, INC., PACIFIC HOLDING CORPORATION, KMI CONTINENTAL, INC., THE CONTINENTAL GROUP, INC., S. BRUCE SMART, JR., DAVID H. MURDOCK, RAYMOND F. HENZE, III, WALTER SCOTT, JR. and DONALD L. STURM,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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August 13, 1987

QUESTIONS PRESENTED[1]

1. Where an immense change in the position of a plaintiff class was brought about by petitioners and their attorneys:

> Can a class action defendant, which by-passes the court, and prevents the creation of a common fund by extending a tender offer directly to, and thereby in effect settling with, the entire class, thereby escape, as a matter of law, from any liability for the payment of petitioners' attorneys' fees?

2. Did the respondents' public tender violate F.R.Civ.P. 23(e), because it was a settlement offer directed at the plaintiff class, which resulted in a dismissal of the class action, without the approval of the court?

3. Should this Court grant this petition because the decision rendered below

(a) conflicts directly and irreconcilably with the decision of the United States Court of Appeals for the Third Circuit in *Kahan* v. *Rosenstiel*, 424 F.2d 161 (3d Cir.) (Adams, J.), *cert. denied*, 398 U.S. 950 (1970); and

(b) conflicts with the class action policy considerations enunciated by this Court in *Deposit Guaranty National Bank* v. *Roper*, 445 U.S. 326 (1980)?

4. Does the spirit and the policy of F.R.Civ.P. 23, apply in the pre-certification stages of a class suit?

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1 The Questions Presented are based upon those stated by Chief Judge Feinberg in his dissenting opinion below, set forth in the Appendix herein beginning at 19a.

PARTIES (AND Rule 28.1 LIST)

The parties to the proceeding are as set forth in the caption. Petitioner Pennsylvania National Mutual Casualty Insurance Company has no parent companies, subsidiaries or affiliates to list pursuant to Rule 28.1, except Pennsylvania National Life Insurance Company, a subsidiary.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

No. ____

CHARLES S. CHRISTENSEN and JENNE CHRISTENSEN, JOINT TENANTS; ALTIE L. CLARK and LENA F. CLARK, JOINT TENANTS; JOHN C. ECHON, INDIVIDUALLY AND AS JOINT TENANT WITH LILLIAN ECHON; JAMES M. HOSS, JR. and MARIAN C. HOSS, JOINT TENANTS; HENRY B. HOSS; DAVID C. KRISER and PENNSYLVANIA NATIONAL MUTUAL CASUALTY INSURANCE COMPANY,

Petitioners,

—against—

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The Petitioners (plaintiffs below), respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit, entered in the above-entitled action on March 26, 1987.

OPINIONS BELOW

The opinion of the Court of Appeals for the Second Circuit is reported at 815 F.2d 206, and is reprinted in the appendix hereto, 1a.[2]

The memorandum decision of the United States District Court for the District of Connecticut (Ellen Bree Burns, D.J.), has not been reported. It appears in the appendix, 25a-30a.

JURISDICTION

The district court denied petitioners' application for counsel fees as a matter of law, and dismissed the amended complaint as moot on November 14, 1986. (30a)

On petitioners' appeal, the Second Circuit, on March 26, 1987, entered a judgment affirming the decision of the district court (18a), and thereafter denied petitioners' motion for rehearing in an order entered on May 15, 1987 (31a), within 90 days prior to filing of this application for a writ of certiorari.

The jurisdiction of this Court to review the judgment of the Second Circuit is invoked under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

At issue in this case is the application of Rule 23(e) of the Federal Rules of Civil Procedure. Rule 23(e) provides:

> (e) *Dismissal or Compromise.* A class action shall not be dismissed or compromised without the approval of the Court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the Court directs.

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2 Pages of the Appendix are cited as "_____a."

STATEMENT OF THE CASE

The jurisdiction of the district court was invoked under Section 22 of the Securities Act of 1933, 15 U.S.C. § 77v and Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa; diversity of citizenship jurisdiction under 28 U.S.C. § 1332; and under pendent jurisdiction.

Chief Judge Feinberg stated in dissent below that "[i]t is important to appreciate the full flavor of what happened here, assuming that plaintiffs' allegations are true, as we must in deciding the issue before us." (19a). There follows his statement of what happened (19a-20a):

In November 1984, petitioners were holders of high grade Series C and Preferred stock in the Continental Group, Inc., which was publicly owned, before that company was merged into a subsidiary of respondent Kiewit-Murdock Investment Corporation ("KMI"), a privately owned company. Under the merger, KMI paid cash for Continental Series A, Series B and Common stock, but holders of Series C and Preferred stock received only stock certificates in the new entity formed as a result of the merger.

Petitioners brought suit, alleging that respondents engaged in unlawful manipulation in violation of federal securities laws, and that respondents breached a fiduciary duty owed to petitioners, by leaving them, after the merger, with "speculative low grade, highly leveraged securities" rather than cash.[3]

In October 1985, KMI announced a tender offer for all outstanding shares of Preferred and Series C stock. That tender offer permitted plaintiffs' counsel to move to dismiss the lawsuit as moot, claiming that the tender offer satisfied the objective of the lawsuit. Thus, the putative class of Series C and Preferred shareholders, who had been shareholders in a publicly owned corporation, found themselves in November 1984 locked into an unattractive position in a new private

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3 Petitioners sought redemption (or similar cashing out) of the stock held by the class, at a fair price.

entity, although all the other stockholders were bought out in cash.

One year later, however, defendants saw to it that the stock owned by the unfortunate members of the putative class was also "cashed out." This immense change in the position of plaintiffs' class was brought about by the efforts of plaintiffs and their attorneys.

Additional relevant facts include the following:

Petitioners' filed their amended complaint and simultaneously moved for class certification. Respondents' motion to stay class certification, was granted by the district court on March 8, 1985, so that their motions to dismiss the amended complaint would be heard first.

In early April 1985, counsel for KMI and the petitioners, negotiated a settlement in principle, subject to court approval pursuant to Rule 23(e).[4] It involved a KMI (or its subsidiary) tender offer for all outstanding Series C and Preferred shares, and the payment of petitioners' reasonable legal fees. However, in June 1985, KMI advised that it was no longer interested in settlement; proceeded with its motion to discuss; and its motion to stay petitioners' discovery, was granted.

In October 1985, just prior to the argument of the motions to dismiss, KMI suddenly announced its tender offer for all outstanding shares of Preferred and Series C stock, coupled with a freeze-out merger under New York law of any remaining shares, if 80 per cent of all shares were tendered. By its tender offer, KMI paid out the $68,390,482 common fund, without court approval directly to the class members. Petitioners' counsel then to moved to dismiss the class action as moot, because Petitioners' objective of cashing out the Series C and the Preferred was accomplished; and, since respondents, in paying out the common fund, had by passed the Court,

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4 As stated by petitioners' counsel who reported on these aborted settlement discussions at oral argument in the district court on the award of attorneys' fees, and in an affidavit filed with the district court.

counsel asked the court to reserve jurisdiction over the award of reasonable attorneys' fees to be paid by respondents.

Both the district court and the Second Circuit majority held that, *as a matter of law*, even though it was petitioners' pressure which generated the benefit,[5] petitioners were not entitled to attorneys' fees from respondents, In so doing, the Second Circuit majority, *inter alia*, rejected the long-standing ruling of the Third Circuit in *Kahan* v. *Rosenstiel*, 424 F.2d 161 (3d Cir., Arlin Adams, J.), *cert. denied*, 398 U.S. 950 (1970). On the other hand, Chief Judge Feinberg said in his dissent, that *Kahan* "is right on point." (21a)[6]

REASONS FOR GRANTING THE WRIT

The Second Circuit's Majority Decision Is Contrary To The Intent Of Rule 23(e), and Conflicts With The Decision Of This Court In *Deposit Guaranty National Bank* v. *Roper*, and That Of The Third Circuit in *Kahan* v. *Rosenstiel*.

Chief Judge Feinberg stated in his dissent:

> "The outcome of this case depends on an analysis of policy views concerning class actions. In my view, the majority has followed the wrong policy." (24a)

The decision below, as the dissent points out, (23a-24a), conflicts directly with sound policy concerns, including the important role of "private attorneys general" played by attorneys in class action suits, that was recognized by this Court in *Deposit Guaranty National Bank* v. *Roper*, 445 U.S. 326, 338 (1980).

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5 They assumed (as they must) that the petitioners' lawsuit created the class's benefit.

6 The district court, in its opinion (25a-30a), ignored *Kahan*, even though it was the judicial decision upon which petitioners principally relied.

In *Roper*, the defendants tendered payment to the named plaintiffs' alone, but not to the rest of the class. As a result, the named plaintiffs' claims were mooted, while the class claims survived. This Court held that the importance which the recovery of counsel fees bears to the fulfillment of the policy goals behind class actions, was so overriding, that it justified the certification and continued prosecution of the class action by the named plaintiffs, even though plaintiffs' claims were mooted. Here, respondents mooted the class claims as well as those of the named plaintiffs. Petitioners have already created the benefit for the class, which the *Roper* plaintiffs were still pursuing. Thus, the policy goals enunciated in *Roper* are equally, if not more apt, to the facts of this case.

Permitting respondents, in effect, to settle this entire class action suit, outside of the scrutiny of the court, flies in the face of *Roper*. Depriving petitioners' attorneys, of fees as a matter of law

> "will almost certainly deter attorneys from bringing class action lawsuits. Certainly, frivolous class suits should be discouraged but, as defendants' actions make clear, this class suit was not frivolous." (Dissenting opinion of Feinberg, Ch. J., 23a.)

The opinion below is also in direct, irreconcilable conflict with the Third Circuit's longstanding, 17-year-old ruling in *Kahan* v. *Rosenstiel*, 424 F.2d 161 (3d Cir.), *cert. denied*, 398 U.S. 950 (1970). There, the Court found that counsel fees would be appropriate where, as here, a tender offer by-pass results in substantial class benefits. Chief Judge Feinberg said below that *Kahan's* "persuasive reasoning as precedent", should apply to the facts of this case. (21a)

In *Kahan* the defendants, as the respondents here, made a public tender offer to potential class members, before a class was certified, without seeking court supervision or approval of the offer. 424 F.2d at 165. The Third Circuit found that defendants' actions could be considered a bad faith attempt to evade the requirements of Rule 23(e) that would support an

award of attorneys fees directly against the defendants. *Id.* at 165, 174.

> "If a court ultimately decides that a plaintiff created substantial benefits for others, it could find it inequitable to deprive plaintiff of counsel fees, merely because defendants prevented the physical creation of [a] fund by flagrantly ignoring Rule 23." (*Id.* at 168)

Here, the respondents, as the dissent below correctly observed, "extended an offer to the entire putative class—an offer that effectively settled the case by mooting the entire action.[7] This is precisely the activity that Rule 23(e) was designed to control through judicial review and supervision." (dissenting opinion, 22a, footnote omitted)[8]

Kahan dealt with the same type of activity which respondents engaged in here, by striking a careful balance between

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7 Respondents' $68 million tender offer mooted the *entire* class action because it was coupled with a freeze-out New York statutory merger. Thus, so long as 80 percent of the class's shares were tendered, any non-tendering shareholders were automatically cashed out in the merger. The district court and the Second Circuit majority ignored the coercive effect of respondents' actions, relying instead upon dictum in an earlier Second Circuit decision applicable only to negotiated settlements with individual potential class members. *Weight Watchers of Philadelphia* v. *Weight Watchers International*, 455 F.2d 770 (2nd Cir. 1972). Indeed, Judge Friendly's opinion in *Weight Watchers* was quick to point out that negotiated settlements with individual class members are very different from an offer to the class as a whole, which could moot the entire action. *Id.* at 773, 775.

8 The majority below strained to reach a conclusion that the respondents' $68 million tender offer/merger did not constitute a settlement with the class, because the class members received less than the petitioners demanded in the complaint, and because the class members did not sign releases. However, the majority ignored the fact (conceded by the respondents), that the tender offer was originally suggested by petitioners' counsel as a means of a court-approved settlement. As the dissent pointed out "[u]nder a realistic view of the terms and timing of defendants' transaction, defendants' public tender offer was clearly a settlement offer directed at the plaintiff class." (22a)

vindicating the intent of Rule 23(e) and avoiding frivolous fee awards. Judge Adams explained that if, after a class complaint is filed but before a class is certified, a defendant makes an offer which moots an action, plaintiffs' attorneys should be entitled to fees if the district court decides that (1) it would have certified the class, (2) the complaint could have withstood a motion to dismiss, and (3) the lawsuit was the proximate cause of any benefit the class received. (424 F.2d 161, 167-68) Indeed, subsequent authority in the Second Circuit has been similar to *Kahan*. *See Koppel* v. *Wien*, 743 F.2d 129, 135 (2d Cir. 1984):

> "Where . . . plaintiffs' lawsuit is mooted by defendants' corrective action, the burden properly shifts to defendants to establish the absence of a causal connection in order to defeat a claim for legal fees." (citations omitted)

The majority decision in the instant case upsets the type of careful balance struck by the *Kahan* court. For the majority held that, as a matter of law, petitioners could not seek to recover a legal fee, no matter how proximately the litigation pressure they brought to bear, caused the $68 million benefit. That result frustrates the intent of Rule 23.

As Chief Judge Feinberg wrote in dissent, the majority holding runs irreconcilably counter to every intendment of Rule 23 and to this Court's decision in *Roper*, *supra*. Chief Justice Burger there recognized the

> "growth of litigation stimulated by contingent-fee agreements and an enlargement of the role this type of fee arrangement has played in vindicating the rights of individuals who otherwise might not consider it worth the candle to embark on litigation in which the optimum result might be more than consumed by the cost. The prospect of such fee arrangements offers advantages for litigation by named plaintiffs in class actions as well as for their attorneys. For better or worse, the financial incentive that class actions offer to the legal profession is a

> mutual outgrowth of the increasing reliance on the 'private attorney general' for the vindication of legal rights; obviously this development has been facilitated by Rule 23." (445 U.S. at 338)

Moreover, as the dissent below points out, "the basis of the Third Circuit's ruling in *Kahan*, *supra*—that the spirit and policies behind Rule 23 may apply in the pre-certification stage of a class suit—is not at all unusual. (21a) *See*, *e.g.*, *Weinberger* v. *Kendrick*, 698 F.2d 61, 73 (2d Cir. 1982) (Friendly, J.), *cert. denied*, 464 U.S. 818 (1983); *Plummer* v. *Chemical Bank*, 668 F.2d 654, 657-58 (2d Cir. 1982); *Simer* v. *Rios*, 661 F.2d 655, 664-66 (7th Cir. 1981), *cert. denied*, 456 U.S. 917 (1982); *In re Beef Industry Antitrust Litigation*, 607 F.2d 167 (5th Cir. 1979) (Wisdom, J.), *cert. denied*, 452 U.S. 905 (1981); *Shelton* v. *Pargo, Inc.*, 582 F.2d 1298 (4th Cir. 1978); 7B C. Wright, A. Miller & M. Kane, Federal Practice and Procedure § 1797, pp. 346-50 (2d ed. 1986) ('courts generally have agreed that actions filed as class suits are within the scope of Rule 23(e) even though they have not been formally certified at the time settlement is reached'); 3B J. Moore, Moore's Federal Practice § 23.80[2], p. 509 & n. 11 (2d ed 1985); Comment, The Applicability of Rule 23(e) to Precertification Proceedings: The Functional Approach Applied, 25 Vill. L. Rev. 487 (1979-80)."

The majority expressed no opinion as to any possible remedies that petitioners may have, to seek to recover their attorneys' fees directly from the benefited class of thousands of shareholders. (15a-16a) If possible, any such remedy would be both unfair and unreasonable. It would mean that defendants, who by-pass the court and Rule 23, could thereby force a class plaintiff to sue his own class *cestui que trust*. Class plaintiffs in similar situations—of which there will be many if the holding below is permitted to stand—should be afforded the opportunity to have the district court "consider whether it would have certified the class, whether the complaint would have withstood a motion to dismiss before defendants mooted the case,

and whether the lawsuit was the proximate cause of any benefit to class". If the answers are affirmative, class plaintiffs should "expect the district court, in the exercise of its discretion to award a reasonable fee under all the circumstances to be paid by defendants." (Dissenting opinion, 24a)

The disposition of most non-frivolous class actions generally involve payment of an attorneys' fee from the common fund or directly by the defendant. A class action plaintiff is often as successful in creating a benefit to the class, before certification, as well as after. The majority's holding undermines that settlement process, denying a plaintiff compensation for his success, just because the defendant brazenly bypasses the court and Rule 23(e). That the petitioners in the instant case were successful, is borne out by the American Law Institute's current position on mootness, which is fully consistent with *Kahan* and the decisions in Delaware.[9]

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9 "*e. Non-necessity of judgment or settlement.* The term 'successful' in § 7.18 includes a plaintiff whose action is mooted by acts taken by the defendants that effectively grants some or all the relief requested in the plaintiff's demand or complaint. The criterion should be whether the plaintiff's demand or complaint was a proximate cause of the relief undertaken by the defendants, not whether plaintiff obtained a judgment or settlement. Case law has so recognized, and Delaware decisions have wisely established a rebuttable presumption of causation, which arises if the plaintiff can demonstrate that the claim or demand he made was 'meritorious.' The term 'meritorious' has in turn been construed to imply not 'absolute assurance of ultimate success, but only that there was some reasonable hope.' *Chrysler Corp.* v. *Dann*, 43 Del. Ch. 252, 223 A.2d 384, 387 (1966). Those decisions that permit the plaintiff to prove causation by showing the 'meritoriousness' of this claim typically also permit defendants to disprove causation by showing that the defendant's actions did not result from the plaintiff's demand or complaint. See Reporter's Note 5 to § 7.18. Such a methodology should be followed by a court in determining whether a plaintiff was 'successful' for purposes of § 7.18. The burden should shift to the defendant to prove the irrelevance of the plaintiff's demand or complaint in securing the relief, once the plaintiff has shown the claim to be meritorious." ALI Principles of Corporate Governance: Tentative Draft No. 6, Analysis and Recommendations (1986); Comment "e" to Section 7.18).

Rule 23(e) applies before, as well as after a class has been certified. Chief Judge Feinberg pointed out that it applies earlier where the court determines that the lawsuit would have been an appropriate class action. (20a) Yet petitioners were completely foreclosed from establishing the propriety of class action treatment. They were equally estopped from establishing that their lawsuit—which had the approval and support of non-plaintiff class members who owned some 535,000 Series C shares—[10] was the proximate cause of the class benefit.

It would be difficult to posit a more flagrant avoidance of the creation of a common fund, than that conceived and consummated by the respondents here. They persuaded the District Court to stay class certification, only because they submitted, that if their motion to dismiss was heard first and granted, class certification would be moot. And then, they themselves unilaterally mooted petitioners' class motion, by making their $68 million tender offer directly to the class, just before oral argument, followed by forceably cashing out those who didn't tender.

Chief Judge Feinberg correctly concluded that where, under such circumstances,

> "a defendant bypasses the court and no [common] fund can be created, neither precedent nor policy reasons justify denying fees to plaintiffs' attorneys as a matter of law. Rather, such action violates Rule 23(e) and fees should be available, if warranted, directly from the defendant." (20a)
>
> * * *
>
> "[T]hrough the public tender offer defendants extended an offer to the entire putative class—an offer that effectively settled the case by mooting the entire action. This is precisely the activity that Rule 23(e) was designed to control through judicial review and supervision. By cir-

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10 Evidenced by affidavits filed in the district court.

cumventing that review and supervision, defendants violated Rule 23." (22a)

The decision below, as Chief Judge Feinberg correctly pointed out, has broad policy ramifications going beyond the matter of attorneys' fees. Yet the majority never considered its effect upon class action practice and the role of the courts in supervising class actions under rule 23(e). Thus, unless the majority decision is reversed, defendants will be permitted to totally defeat attorneys' fees, as a matter of law, even in the most meritorious cases.

The clear result of the two to one decision below, and its direct conflict with *Kahan*, will be pre-certification chaos. For, notwithstanding the admonition of Rule 23 that certification be determined "as soon as practicable after commencement", the majority invites corporate defendants to adopt, as routine strategy, the delaying of class certification in all cases. And it encourages forum shopping by plaintiffs, among the circuits, to avoid such a harsh result.

This Court should grant certiorari to consider the important policy considerations present in this case, resolve the direct and irreconcilable conflict between the decision in this case and that of the Third Circuit in *Kahan*, and give needed guidance to the lower courts as to the conduct and supervision of class actions, and the applicability of Rule 23(e), in the pre-certification stage.

CONCLUSION

A writ of certiorari should issue to review the judgment of the Second Circuit and resolve the conflict between the Second and Third Circuits.

Respectfully submitted,

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APPENDIX

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Majority Opinion of the Second Circuit

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 814—August Term, 1986

(Argued: February 19, 1987 Decided: March 26, 1987)

Docket No. 86-7964

CHARLES S. CHRISTENSEN and JENNE CHRISTENSEN, Joint Tenants; ALTIE L. CLARK and LENA F. CLARK, Joint Tenants; JOHN C. ECHON, individually and as Joint Tenant with LILLIAN ECHON; JAMES M. HOSS, JR., and MARIAN C. HOSS, Joint Tenants; HENRY B. HOSS; DAVID C. KRISER; PENNSYLVANIA NATIONAL MUTUAL CASUALTY INSURANCE COMPANY,

Plaintiffs-Appellants,

—v.—

KIEWIT-MURDOCK INVESTMENT CORPORATION, PETER KIEWIT SONS, INC., PACIFIC HOLDING CORPORATION, KMI CONTINENTAL INC., THE CONTINENTAL GROUP, INC., S. BRUCE SMART, JR., DAVID H. MURDOCK, RAYMOND F. HENZE, III, WALTER SCOTT, JR., DONALD L. STURM,

Defendants-Appellees.

Before:

FEINBERG, *Chief Judge*, TIMBERS and PRATT,
Circuit Judges.

Appeal from that part of a judgment entered in the District of Connecticut, Ellen Bree Burns, *District Judge*, which denied appellants' application to recover attorneys' fees and costs from one of the appellees in a federal securities action which was dismissed as moot.

Affirmed.

Chief Judge Feinberg filed a dissenting opinion.

Edward L. Sadowsky, New York, N.Y. (William Klein, II, Ira A. Finkelstein, Judah S. Shapiro, and Tenzer, Greenblatt, Fallon & Kaplan, New York, N.Y.; Richard S. Lipman, and Schatz & Schatz, Ribicoff & Kotkin, Hartford, Conn., on the brief), *for appellants*.

Daniel J. Beller, New York, N.Y. (Kevin McNulty, and Paul, Weiss, Rifkind, Wharton & Garrison, New York, N.Y.; Stuart Bear, Paul F. Thomas, and Zeldes, Needle & Cooper, Bridgeport, Conn., on the brief), *for appellees*.

TIMBERS, *Circuit Judge*:

Appellants Charles S. Christensen and others ("appellants") appeal from that part of a judgment entered November 14, 1986 in the District of Connecticut, Ellen Bree Burns, *District Judge*, which denied their application to recover attorneys' fees and costs from appellee Kiewit-Murdock Investment Corpora-

tion ("Kiewit Corp."). The judgment also dismissed as moot appellants' action under the federal securities laws and New York State common law; appellants do not appeal from that part of the judgment.

Appellants' action arose out of a merger of appellee The Continental Group, Inc. ("Continental") into a subsidiary of Kiewit Corp., forming appellee KMI Continental Inc. ("KMI Continental"). Appellants held certain classes of Continental stock prior to the merger. Under the terms of the merger, appellants received stock of KMI Continental in exchange for their Continental stock. Holders of other classes of Continental stock received cash.

In their amended complaint, appellants alleged that the financial structure of the merger had left KMI Continental so debt-ridden that their KMI Continental stock was of lesser value than had been their Continental stock. Appellants sought an order compelling appellees Kiewit Corp. and others ("appellees") to redeem all outstanding KMI Continental stock.

After appellants filed their amended complaint, they moved in the district court for certification of a plaintiff class consisting of the holders, and their successors, of the Continental stock that had been exchanged for KMI Continental stock. The district court reserved decision on that motion pending disposition of appellees' motions to dismiss the amended complaint.

Before oral argument on appellees' motions to dismiss and without notifying the court, Kiewit Corp. acquired a substantial majority of KMI Continental stock through a tender offer. Appellants pressed their motion in the district court to dismiss their action as moot, asserting that the tender offer conferred on the class substantially the same relief which had been sought in the amended complaint. Appellants also applied to the court for an award to appellants of their attorneys' fees and costs to be paid by Kiewit Corp.

In a well reasoned opinion filed October 10, 1986, the district court granted appellants' motion to dismiss their action as moot, but denied their application for attorneys' fees and costs.

On appeal from the denial of their application for attorneys' fees and costs, appellants recognize that under the "American Rule" litigants ordinarily pay their own attorneys' fees. They claim, however, that three exceptions to that rule apply to the instant action. They claim, first, that they are entitled to attorneys' fees and costs under the "common fund" doctrine; second, that the "bad faith" exception applies to the instant action because Kiewit Corp's tender offer constituted a "flagrant avoidance" of Fed. R. Civ. P. 23(e), which bars dismissal or compromise of class actions without court approval; and third, as an afterthought on appeal, that they should be permitted to recover attorneys' fees from Kiewit Corp. under a New York statute.

We hold, first, that the common fund doctrine does not apply to the instant action because appellants seek fees and costs from Kiewit Corp., not from any "fund" or from those persons who purportedly have benefited from appellants' law suit; second, that appellants are not entitled to fees and costs under the "bad faith" exception because Kiewit Corp.'s tender offer did not constitute a violation of Rule 23(e); and, third, that appellants' claim under the New York statute, first asserted on appeal, is not properly before this Court because appellants did not assert that claim in the district court.

We affirm.

I.

The facts are straightforward and not in dispute. We summarize only those facts believed necessary to an understanding of the issues raised on appeal.

Continental was a publicly held diversified corporation engaged primarily in the business of packaging, insurance, forestry products, and energy. In Spring 1984, Continental became the target of a corporate takeover. One of the bidders was Kiewit Corp., now known as Kiewit Investment Corporation. On June 29, 1984, Continental's Board of Directors voted to accept Kiewit Corp.'s offer of a $2.9 billion leveraged buyout. Under a merger agreement entered into the same day, Continental was to merge into a subsidiary of Kiewit Corp.,

forming KMI Continental. The merger agreement set forth the consideration to be given for each class of Continental stock. Holders of Continental common stock and Series A and B preference stock were to be paid cash in exchange for their shares; holders of Continental preferred stock ("Continental preferred") and Series C preference stock ("Continental Series C") were to receive, respectively, KMI Continental preferred stock ("KMI preferred") and Series C preference stock ("KMI Series C").

The instant action was commenced on September 21, 1984. On September 26, Continental's shareholders voted overwhelmingly to approve the merger. It was consummated on November 1.

After proceedings not relevant to the instant appeal, appellants filed an amended class action complaint on January 22, 1985. Appellants are holders of either KMI preferred or KMI Series C, having received those shares in exchange for Continental preferred and Continental Series C as a result of the merger.

The amended complaint named as corporate defendants ("the corporate appellees"), in addition to the appellees heretofore described, appellees Peter Kiewit Sons, Inc., and Pacific Holding Corporation, which own, respectively, 80% and 20% of Kiewit Corp. Appellee S. Bruce Smart, Jr., ("Smart") was Chairman of the Board of Directors of Continental and its Chief Executive Officer on June 29, 1984—the date Continental's Board voted to accept Kiewit Corp.'s offer. Appellees David H. Murdock, Raymond T. Henze, III, Walter Scott, Jr., and Donald R. Sturm ("the KMI Board appellees") were appointed to Continental's Board of Directors, and became members of KMI Continental's Board, pursuant to the merger agreement.

The amended complaint alleged among other things that appellees' "failure to cash out the [Continental] Series C and the Preferred, as they were cashing out the [Continental] Common Stock, the Series A and the Series B . . . [s]ubmerge[d] the Series C and the Preferred into the privately owned KMI Continental, with debt so great that its credit

rating would be far lower and far more speculative than Continental's." (Appellants described their claim in a mixed metaphor in their brief in this Court: "These stockholders were left to twist slowly in the breeze, while the company was being dismantled around them.") Appellants claimed that the financial structure of the merger constituted both a breach of fiduciary duty under New York State common law and a manipulative scheme or device to defraud in violation of § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1986). The amended complaint sought among other things an order compelling appellees to redeem all KMI preferred and KMI Series C at, respectively, $110 and $53.50 per share.

On January 30, 1985, appellants moved in the district court under Fed. R. Civ. P. 23(a), (b)(1), and (b)(2), to certify a class consisting of the beneficial owners on June 29, 1984 (the date of the merger agreement), and their successors, of Continental preferred and Continental Series C. By an order filed March 8, 1985, the court reserved decision on the certification motion, believing that "defendants' motion to dismiss should be addressed first."

In a motion filed July 3, 1985, the corporate appellees and the KMI Board appellees moved in the district court to dismiss the amended complaint for failure to state a claim upon which relief can be granted, Fed. R. Civ. P. 12(b)(6), and for failure to plead fraud with particularity, Fed. R. Civ. P. 9(b). Smart filed similar motions on August 12 and September 16, 1985.

On September 3, 1985, the court granted a motion by appellees to stay discovery pending disposition of their motions to dismiss.

Appellants filed a memorandum and affidavits in opposition to the motions to dismiss on September 19, 1985.

On October 1, 1985, Kiewit Corp. commenced a tender offer for all of the outstanding shares of KMI preferred and KMI Series C, at, respectively, $55.50 and $45.00 per share. Appellees did not notify the court that Kiewit Corp. was commencing the tender offer. The Offer to Purchase submitted to KMI

Continental shareholders in connection with the tender offer provided full disclosure of the instant action.

In a letter to appellants dated October 18, 1985, their counsel stated that "[i]f you tender your Series C and Preferred shares, we will of course, as Plaintiffs' counsel in the class action litigation, argue as effectively as we can that you have not lost your right to assert claims in that action."

As a result of the tender offer, Kiewit Corp. acquired a substantial majority of KMI preferred and KMI Series C.

The district court heard oral argument on appellees' motions to dismiss on December 9, 1985. At the conclusion of a lengthy presentation on behalf of appellees, appellants' counsel announced that appellants were making a motion in the district court to dismiss the action as moot since the tender offer provided the class with relief "substantially equivalent" to that sought in the amended complaint. In papers in support of their motion to dismiss filed January 8, 1986, appellants argued that "notice of dismissal is not required by Rule 23".

Appellants applied to the district court on March 11, 1986 for an award of attorneys' fees and costs in the amount of $3,575,699, to be paid by Kiewit Corp. The court heard oral argument on that application on May 13, 1986.

In its opinion filed October 10, 1986, the court granted appellants' motion to dismiss the action as moot, but denied their application for fees and costs. After a careful analysis, the court rejected appellants' claim for fees and costs under the common fund doctrine and the bad faith exception. The court did not address appellants' claim under the New York statute because appellants did not make that claim in the district court.

From the judgment entered on the court's opinion, the instant appeal was taken. In their notice of appeal appellants stated that they were appealing "from the final judgment entered in this action on October 10, 1986, from the Order staying plaintiffs' motion for class action certification, from the Order staying all discovery by the plaintiffs, and from all other Orders decided adversely to plaintiffs in this action." We treat appellants' appeal from the "final judgment" as being

from the judgment entered November 14, 1986. Further, we treat the appeal from the final judgment as being only from that part of the judgment denying appellants' application for fees and costs, as it is clear from appellants' brief and oral argument in our Court that they do not challenge the dismissal of their action as moot. As to the appeal from the order staying decision of appellants' motion for class certification, we review the propriety of that order on the appeal from the final judgment. As for the appeal from the order staying discovery and "from all other Orders . . .", appellants have made no claims regarding those orders in our Court.

For the reasons stated below, we affirm the judgment of the district court.

II.

In *Alyeska Pipeline Service Co.* v. *Wilderness Society*, 421 U.S. 240 (1975), the Supreme Court recognized and reaffirmed the long-standing "American Rule" that, absent a statutory or common law exception, "the prevailing litigant is ordinarily not entitled to collect a reasonable attorneys' fee from the loser." 421 U.S. at 247.

As we have stated above, appellants claim that three such exceptions apply to the instant action and hence that the district court erred in denying their application for attorneys' fees and costs.

A.

First, appellants claim that they are entitled to fees and costs under the common fund doctrine.

It is within "the historic power of equity to permit . . . a party . . . recovering a fund for the benefit of others in addition to himself, to recover his costs, including his attorneys' fees, from the fund . . . itself or directly from the other parties enjoying the benefit." *Alyeska*, *supra*, 421 U.S. at 257. The common fund doctrine "stands as a well-recognized exception to the general principle that requires every litigant to bear his own attorney's fees". *Boeing Co.* v. *Van Gemert*, 444 U.S. 472, 478 (1980).

Appellants argue that the amount paid by Kiewit Corp. for the KMI preferred and KMI Series C during the tender offer constitutes the "fund" in the instant case, that the tender offer would not have been made but for their action against appellees, and therefore that they are entitled to a percentage of that "fund" as an award of attorneys' fees and costs.

Even assuming that there was a causal relationship between appellants' law suit and Kiewit Corp.'s tender offer—a proposition as to which we express no opinion—appellants' argument is without merit. The award appellants seek would not be payable out of any "fund". Nor would it be taxed against persons who have derived benefit from appellants' law suit. Rather, the award would be taxed directly against Kiewit Corp. Such a result finds no support either in the rationale for the common fund doctrine or in the cases on which appellants rely. As the district court correctly concluded, appellants' claim "is without legal basis".

The common fund doctrine "rests on the perception that persons who obtain the benefit of a lawsuit without contributing to its cost are unjustly enriched at the successful litigant's expense." *Boeing*, *supra*, 444 U.S. at 478. Consistent with this perception, the doctrine has been applied to award fees against a fund created by the plaintiff for the benefit of others, *e.g.*, *id.*; to award fees against a fund not created by the plaintiff but redistributed as a result of its attorneys' efforts, *e.g.*, *United States* v. *American Society of Composers, Authors and Publishers*, 466 F.2d 917, 918-19 (2 Cir. 1972); and, in shareholder derivative actions, to award fees indirectly against other shareholders benefiting from the law suit by taxing the nominal corporate defendant, *e.g.*, *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 396-97 (1970). In *Mills*, the Supreme Court explained the rationale underlying application of the common fund doctrine to shareholder derivative actions:

> "To award attorneys' fees in such a suit to a plaintiff who has succeeded in establishing a cause of action is not to saddle the unsuccessful party with the expenses but to impose them on the class that has benefited from them

> and that would have had to pay them had it brought the suit."

396 U.S. at 396-97.

In the instant case, appellants do not claim, and there is no basis for holding, that Kiewit Corp. has benefited from appellants' law suit or that it has been "unjustly enriched at [appellants'] expense." *Boeing*, *supra*, 444 U.S. at 478. Indeed, assuming without deciding that appellants' law suit was successful, to award fees and costs against Kiewit Corp. *would be* "to saddle the unsuccessful party with the expenses". *Mills*, *supra*, 396 U.S. at 396.

The rationale underlying the common fund doctrine compels the conclusion that it has no application whatever to the instant case. *Cf. Bailey* v. *Meister Brau, Inc.*, 535 F.2d 982, 995 (7 Cir. 1976) ("Counsel fees may not be awarded in derivative actions where they would effectively cast the litigation expenses of the prevailing party on a losing adversary."); *Hander* v. *San Jacinto Junior College*, 519 F.2d 273, 280-81 (5 Cir. 1975) (reversing fee award against college because award would not shift costs to benefited teachers and employees).

The case on which appellants place primary reliance, *Koppel* v. *Wien*, 743 F.2d 129 (2 Cir. 1984), is not to the contrary. In *Koppel*, two participants in a real estate venture sued two of the venture's general partners, seeking to enjoin a modification of the venture agreement. After commencement of the law suit, the defendants decided not to modify the agreement, and the suit was dismissed. The issue before our Court was whether the law suit "entitle[d] the plaintiffs to recover their attorney's fees for having conferred a benefit on the [venture's] participants." 743 F.2d at 130. In remanding the case to the district court to consider whether there was a causal connection between the law suit and the defendants' decision not to modify the agreement, we suggested that a fee award against the defendants might be appropriate if it "would result in a pass-through of such litigation costs to all the [venture's] participants." *Id.* at 135. We observed that "[t]he better course,

however, would be to impose any award directly upon [the venture]." *Id.*

We fail to see the relevance to the instant case of the massive reliance placed by appellants on *Koppel*. *Koppel* merely applies in the partnership context those principles applied in the derivative action context by the Supreme Court in *Mills*. In the instant case, an award of attorneys' fees and costs against Kiewit Corp. would not "pass-through" to any of the stockholders purportedly benefiting from appellants' law suit. Rather, Kiewit Corp. would have to bear those expenses alone. We conclude that *Koppel* does not support appellants' claim.

Accordingly, we hold that the common fund doctrine does not apply to the instant action because appellants seek fees and costs from Kiewit Corp., not from any "fund" or from those persons who purportedly have benefited from appellants' law suit.

B.

Second, appellants claim that they are entitled to fees and costs under the so-called "bad faith" exception to the American Rule.

Under the bad faith exception, "a court may assess attorneys' fees . . . when the losing party had 'acted in bad faith, vexatiously, wantonly, or for oppressive reasons. . . .' " *Alyeska, supra*, 421 U.S. at 258-59 (quoting *F.D. Rich Co. v. United States ex rel. Industrial Lumber Co.*, 417 U.S. 116, 129 (1974)). Appellants argue that appellees acted in bad faith by "launch[ing] their extra-judicial settlement with the class [in] flagrant avoidance of Rule 23". Rule 23(e) provides that "[a] class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs." According to appellants, Kiewit Corp.'s tender offer constituted a compromise of a class action made without court approval. Since the effect of the tender offer was to make the creation of a common fund impossible, so appellants' argument goes, Kiewit Corp. should be taxed with appellants' costs and attorneys' fees.

Appellants base their argument on *Deposit Guaranty National Bank* v. *Roper*, 445 U.S. 326 (1980), and *Kahan* v. *Rosenstiel*, 424 F.2d 161 (3 Cir.), *cert. denied*, 398 U.S. 950 (1970).

Deposit Guaranty does not support appellants' argument. There, the Court held that the tender of a full monetary settlement to the named plaintiffs and the entry of judgment in their favor does not bar an appeal from an order denying class certification if the plaintiff retains an economic interest in such certification. 445 U.S. at 336-37. In so holding, the Court recognized that "[a] significant benefit to claimants who choose to litigate their individual claims in a class-action context is the prospect of reducing their costs of litigation, particularly attorney's fees, by allocating such costs *among all members of the class who benefit from any recovery*." *Id.* at 338 n.9 (emphasis added). All else aside, *Deposit Guaranty* does not address any issue relevant to appellants' claim of an entitlement to fees under the bad faith exception to the American Rule.

In *Kahan*, the plaintiff, a minority shareholder, commenced a class action against the directors of the corporation. He alleged that the directors had violated federal securities laws in offering the majority shareholder more money for his shares than was offered to minority shareholders. After commencement of the action, the directors increased the offer to the minority shareholders. When the shareholders accepted the directors' offer, the district court, noting that the plaintiff never had moved to certify the class, *Kahan* v. *Rosensteil*, 300 F. Supp. 447, 452 n.9 (D. Del. 1969), dismissed the action as moot and denied the plaintiff's application for attorneys' fees. In reversing, the Third Circuit stated:

> "[P]laintiff seeks the highly unusual relief of having counsel fees paid by an adverse party. . . . [W]here the behavior of a litigant has reflected a willful and persistent 'defiance of the law', a court of equity has the power to charge an adverse party with plaintiff's counsel fees

> . . . . Such awards, however, are clearly reserved for exceptional cases. . . .
>
> *In order to place himself within the scope of these cases, plaintiff here points to defendants' conduct in settling the suit without consulting plaintiff, his counsel or the court, and thus in plaintiff's words, 'brazenly ignoring Rule 23(e).' If a court ultimately decides that a plaintiff created substantial benefit for others, it could find it inequitable to deprive plaintiff of counsel fees, merely because defendants prevented the physical creation of the fund by flagrantly ignoring Rule 23.*"

424 F.2d at 167-68 (footnote and citations omitted) (emphasis added).

Kahan is analogous to the instant case in that appellants also point to a violation of Rule 23(e) as the basis for the conclusion that appellees acted in bad faith. The instant case, however, is not an "exceptional" one justifying an award of fees against Kiewit Corp. because, in view of *Weight Watchers of Philadelphia, Inc.* v. *Weight Watchers International, Inc.*, 455 F.2d 770 (2d Cir. 1972) (Friendly, J.), appellees here did not violate Rule 23(e); nor did they "flagrantly", or even "brazenly", ignore it. In *Weight Watchers*, the plaintiff, representative of a putative class, appealed from an interlocutory order of the district court permitting the defendant under certain conditions to negotiate settlements with members of the class. There, as here, the class had not been certified. In dismissing for lack of appellate jurisdiction, Judge Friendly, writing for our Court, stated:

> "[E]ven if defendant should succeed in settling with so many [members of the putative class] that the court will be forced to deny class action status, plaintiff's complaint will remain untouched. As we have, in essence, already noted, plaintiff has no legally protected right to sue on behalf of other[s] who prefer to settle; F.R.Civ.P. 23(e), requiring court approval of the dismissal or compromise of a class action, does not bar non-approved settlements with individual members which have no effect upon the rights of others."

455 F.2d at 775 (citing *Webster Eisenlohr* v. *Kalodner*, 145 F.2d 316 (3 Cir. 1944) (en banc), *cert. denied*, 325 U.S. 867 (1945)). We take judicial notice that Judge Friendly was thoroughly familiar with the Third Circuit decisions in this area, having cited in *Weight Watchers* the Third Circuit en banc decision in *Kalodner* and having declined to cite the Third Circuit's decision in *Kahan* (the latter decided 24 years after the former).

Weight Watchers establishes that, at least prior to class certification, defendants do not violate Rule 23(e) by negotiating settlements with potential members of a class. In the instant case, therefore, even if the tender offer were deemed to have been a settlement or "compromise", Kiewit Corp. neither violated nor ignored Rule 23(e). There is simply no basis for concluding that any of the appellees acted in bad faith, justifying an award of attorneys' fees and costs.

Indeed, it appears that the tender offer did not even rise to the level of a "settlement" which was approved in *Weight Watchers*. The tender offer here did not result in the relinquishment of any claim by any member of the putative class. As a result of the tender offer, KMI Continental stockholders received less for their shares than was claimed in appellants' amended complaint. Moreover, the tender offer did not reach a class as broad as the one appellants sought to have certified: appellants moved to certify a class including holders of Continental stock at the time of Kiewit Corp.'s buy-out of Continental, as well as holders of KMI Continental stock at the time of Kiewit Corp.'s tender offer. No potential member of the class signed a release.

Although not dispositive of appellants' claim under the bad faith exception, it strikes us as noteworthy, in light of their arguments in the district court on their motion to dismiss on mootness grounds, that appellants would have us hold that Kiewit Corp.'s tender offer violated Rule 23(e). In urging the district court to dismiss the action as moot, appellants asserted that "notice of dismissal is not required by Rule 23", notwithstanding that such dismissal would, and indeed did, result in the relinquishment of claims. By contrast, appellants seek to persuade us that Rule 23 barred Kiewit Corp.'s tender offer,

even though that offer did not lead to the relinquishment of any claim by any member of the putative class.

In connection with their claim under the bad faith exception, appellants argue that the district court erred in reserving decision on their class certification motion pending disposition of appellees' motions to dismiss the amended complaint. We find that argument to be without merit since the procedure followed by the court was well within its discretion. *E.g.*, *Wright* v. *Schock*, 742 F.2d 541, 544 (9 Cir. 1984) (district court had discretion to decide summary judgment motion before class certification motion so as "to protect both the parties and the court from needless and costly further litigation."). In any particular case, such procedure may or may not be appropriate depending on the complexity of the legal or factual issues raised by the motion to certify. In light of the breadth of the class appellants sought to certify, and in light of the absence of any showing that the court abused its discretion, we hold that the court did not abuse its discretion in reserving decision on the motion to certify pending the outcome of the motions to dismiss.

Moreover, even if we were to conclude that the court abused its discretion, appellants' claim under the bad faith exception still would fail. If we were to hold on appeal that the district court committed an error, that would not transform Kiewit Corp.'s tender offer, lawful at the time it was made, into an act of bad faith justifying an award of attorneys' fees. At the time of the tender offer, the class had not been certified. Under *Weight Watchers*, Kiewit Corp. did not violate Rule 23(e).

We hold that appellants are not entitled to attorneys' fees and costs under the bad faith exception to the American Rule because Kiewit Corp.'s tender offer did not constitute a violation of Rule 23(e).

In light of the facts and circumstances of this case, we find it neither necessary nor appropriate to address the question whether Kiewit Corp.'s tender offer would have violated Rule 23(e) if it had been made *after* certification of the class. Nor do we express any opinion as to any possible remedies that appellants may have to recover attorneys' fees and costs

from the KMI Continental stockholders who purportedly benefited from appellants' law suit.

C.

Finally, appellants claim that the district court erred in denying their application because they were entitled to attorneys' fees and costs under Section 909 of the New York Civil Practice Law and Rules, N.Y. Civ. Prac. L. & R. § 909 (McKinney 1976).

State statutes providing for awards of attorneys' fees and costs ordinarily apply to state law claims made in a federal court. *Alyeska*, *supra*, 421 U.S. at 259 n.31. Section 909 therefore potentially might have been applicable to the instant case since the amended complaint asserted a claim for breach of fiduciary duty under New York common law.

Section 909 provides:

> "If a judgment in an action maintained as a class action is rendered in favor of the class, the court in its discretion may award attorneys' fees to the representatives of the class based on the reasonable value of legal services rendered and if justice requires, allow recovery of the amount awarded from the opponent of the class."

Appellants argue in our Court that "justice requires" allowance of a recovery of fees and costs "from the opponent of the class." They make this argument notwithstanding the lack of class certification, the lack of a judgment "rendered in favor of the class", and hence notwithstanding the apparent inapplicability of Section 909 to the instant case. *See Froehlich* v. *Toia*, 71 A.D.2d 824, 825, 419 N.Y.S.2d 386, 387-88 (4th Dep't 1979) ("Where class action status is not obtained . . . attorneys fees may not be awarded (CPLR 909)."), *appeal denied*, 48 N.Y.2d 611, 401 N.E.2d 919, 425 N.Y.S.2d 1026 (1980); *Suffolk Housing Services* v. *Town of Brookhaven*, 69 A.D.2d 242, 249, 418 N.Y.S.2d 452, 457 (2d Dep't) (Section 909 applicable only to actions "which were properly designated as class actions."), *appeal dismissed*, 48 N.Y.2d 652, 396 N.E.2d 485, 421 N.Y.S.2d 202 (1979), and *appeal dismissed*, 49 N.Y.2d 799, 403 N.E.2d 458, 426 N.Y.S.2d 735 (1980); 2 Weinstein, Korn &

Miller, New York Civil Practice ¶ 909.2, at 9-194 (1986) ("Before the provisions of CPLR 909 may be invoked, there must be a class. Unless a class is certified, there is no procedure by which the attorneys for the plaintiffs may recover fees from anyone other than the plaintiffs.").

It is neither necessary nor appropriate, however, for us to decide the extent, if any, to which Section 909 might apply to the instant case, since appellants failed to assert their claim based on the statute in the district court. If, as appellants now assert on appeal, "Judge Burns apparently concluded that only federal law was implicated in her consideration of plaintiff's application for legal fees", she apparently did so only because appellants made no mention of Section 909, or any other state statute, in their moving papers, affidavits, or at oral argument on their application for fees and costs. Under such circumstances and in the absence of some extraordinary need not here present for us to do so, we decline to consider appellants' claim under the statute. *Singleton* v. *Wulff*, 428 U.S. 106, 120 (1976) ("It is the general rule . . . that a federal appellate court does not consider an issue not passed upon below."); *Grace Towers Tenants Association* v. *Grace Housing Development Fund Co., Inc.*, 538 F.2d 491, 495 (2 Cir. 1976) ("By failing to urge [a] claim below, [appellants] may be held to have waived it."), *Terkildsen* v. *Waters*, 481 F.2d 201, 204 (2 Cir. 1973) (Feinberg, J.) (where the appellant failed to press an issue in the district court either before entry of judgment or after such entry by motion pursuant to Fed. R. Civ. P. 59(e), "we see no reason to depart from the general rule of practice which forecloses appellate consideration of issues not raised below.").

Accordingly, we decline to consider appellants' claim under Section 909 because appellants did not assert that claim in the district court.

III.

To summarize:

Under the "American Rule", a litigant ordinarily must bear his own expenses of litigation and cannot recover his attorneys'

fees and costs from the losing party absent a statutory or common law exception.

Appellants claim that the district court erred in denying their application for an award of attorneys' fees and costs against Kiewit Corp. since three exceptions to the American Rule apply to their action.

The common fund doctrine permits a party who has recovered a fund for the benefit of others in addition to himself to recover his fees and costs from the fund or from the persons enjoying the benefit. We hold that the doctrine does not apply to the instant action because appellants seek fees and costs from Kiewit Corp., not from any "fund" or from those persons who purportedly have benefited from appellants' law suit.

Similarly unavailing is appellants' claim to an entitlement to attorneys' fees under the bad faith exception. Appellants base that claim on the theory that Kiewit Corp.'s tender offer constituted an extra-judicial settlement in violation of Rule 23(e). The *Weight Watchers* decision by Judge Friendly, however, establishes that, at least prior to class certification, defendants do not violate Rule 23(e) by negotiating settlements with potential members of the class. Accordingly, we hold that appellants are not entitled to fees and costs under the bad faith exception because Kiewit Corp.'s tender offer did not constitute a violation of Rule 23(e). We do not address the question whether Kiewit Corp.'s tender offer would have violated Rule 23(e) if it had been made *after* certification of the class.

As for appellants' claim that they are entitled to fees and costs under Section 909 of the New York Civil Practice Law and Rules, we decline to consider that claim because appellants did not assert it in the district court.

We affirm the judgment of the district court denying appellants' application to recover attorneys' fees and costs from Kiewit Corp. and we do so essentially on the excellent opinion of Judge Burns in the district court.

Affirmed.

Dissenting Opinion of the Second Circuit

FEINBERG, Chief Judge (dissenting):

I respectfully dissent.

The question before us is whether a defendant can go outside of the judicial structure to settle in effect with an entire class and thereby bar, as a matter of law, what appears to be a meritorious claim of plaintiffs' attorneys for fees. Because I believe that such action may constitute a bad faith evasion of Rule 23(e) of the Federal Rules of Civil Procedure that would justify an award of attorney's fees against defendants, I write separately in dissent.

It is important to appreciate the full flavor of what happened here, assuming that plaintiffs' allegations are true, as we must in deciding the issue before us. In November 1984, plaintiffs were holders of Series C and Preferred stock in Continental Group, Inc., which was publicly owned, before that company was merged into a subsidiary of defendant Kiewit-Murdock Investment Corporation (KMI), a privately owned company. Under the merger, KMI paid cash for Continental Series A, Series B and Common stock, but holders of Series C and Preferred stock received only stock certificates in the new entity formed as a result of the merger. Plaintiffs brought suit, alleging that defendants engaged in unlawful manipulation in violation of federal securities laws and that defendants breached a fiduciary duty owed to plaintiffs, by leaving them, after the merger, with "speculative low grade, highly leveraged securities" rather than cash. In October 1985, KMI announced a tender offer for all outstanding shares of Preferred and Series C stock. That tender offer prompted plaintiffs' counsel to move to dismiss the lawsuit as moot, claiming that the tender offer satisfied the objective of the lawsuit. Thus, the putative class of Series C and Preferred shareholders, who had been shareholders in a publicly owned corporation, found themselves in November 1984 locked into an unattractive position in a new private entity, although all the other stockholders were bought out in cash. One year later,

however, defendants saw to it that the stock owned by the unfortunate members of the putative class was also "cashed out." This immense change in the position of plaintiffs' class was brought about by the efforts of plaintiffs and their attorneys.

We must therefore decide whether defendants, having corrected under pressure an injustice to the putative class, are immune as a matter of law from a claim by plaintiffs for attorney's fees. The district court denied plaintiffs' claim for attorney's fees holding, among other things, that "Rule 23 does not appear to apply in situations such as the present where, prior to the certification of a class, a defendant takes some action which has the effect of mooting the claims of potential class members." The majority agrees that defendants cannot be held liable to plaintiffs for any fee. I respectfully disagree.

When a defendant makes an offer that moots an action after a class complaint is filed, but before a class is certified, plaintiffs' attorneys should be entitled to fees if the district court decides that (1) it would have certified the class, (2) the complaint could have withstood a motion to dismiss and (3) the lawsuit was the proximate cause of any benefit the class received. Kahan v. Rosensteil, 424 F.2d 161, 167-68 (3d Cir.), cert. denied, 398 U.S. 950 (1970). Cf. Koppel v. Wien, 743 F.2d 129, 135 (2d Cir. 1984) ("Where . . . plaintiffs' lawsuit is mooted by defendants' corrective action, the burden properly shifts to defendants to establish the absence of a causal connection in order to defeat a claim for legal fees.") (citations omitted). Plaintiffs' attorneys would then most likely be entitled to fees from a "common fund" consisting of monies from defendant's offer. Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970). When, however, a defendant by-passes the court and no such fund can be created, neither precedent nor policy reasons justify denying fees to plaintiffs' attorneys as a matter of law. Rather, such action violates Rule 23(e) and fees should be available, if warranted, directly from the defendant.

The force of persuasive reasoning as precedent supports this approach. Judge Arlin Adams' opinion in *Kahan v. Rosensteil* is right on point. As in this case, defendants in *Kahan* made a public offer to potential class members, before a class was certified, without seeking court supervision or approval of the offer. 424 F.2d at 165. The Third Circuit found that defendants' action could be considered a "bad faith" attempt to evade the requirements of Rule 23(e), that could support an award of attorney's fees against defendants. Id. at 165, 174. The *Kahan* court wrote,

> If a court ultimately decides that a plaintiff created substantial benefit for others, it could find it inequitable to deprive plaintiff of counsel fees, merely because defendants prevented the physical creation of [a] fund by flagrantly ignoring Rule 23.

Id. at 168 (footnote omitted).

Moreover, the basis of this ruling—that the spirit and policies behind Rule 23 may apply in the pre-certification stage of a class suit—is not at all unusual. See, e.g., Weinberger v. Kendrick, 698 F.2d 61, 73 (2d Cir. 1982) (Friendly, J.), cert. denied, 464 U.S. 818 (1983); Plummer v. Chemical Bank, 668 F.2d 654, 657-58 (2d Cir. 1982); Simer v. Rios, 661 F.2d 655, 664-66 (7th Cir. 1981), cert. denied, 456 U.S. 917 (1982); In re Beef Industry Antitrust Litigation, 607 F.2d 167 (5th Cir. 1979) (Widsom, J.), cert. denied, 452 U.S. 905 (1981); Shelton v. Pargo, Inc., 582 F.2d 1298 (4th Cir. 1978); 7B C. Wright, A. Miller & M. Kane, Federal Practice and Procedure § 1797, pp. 346-50 (2d ed. 1986) ("courts generally have agreed that actions filed as class suits are within the scope of Rule 23(e) even though they have not been formally certified at the time settlement is reached"); 3B J. Moore, Moore's Federal Practice ¶ 23.80[2], p. 509 & n.11 (2d ed. 1985); Comment, The Applicability of Rule 23(e) to Precertification Proceedings: The Functional Approach Applied, 25 Vill. L. Rev. 487 (1979-80).

The majority relies heavily on Judge Friendly's opinion in Weight Watchers of Philadelphia v. Weight Watchers International, 455 F.2d 770 (2d Cir. 1972), which preceded by a decade

his opinion in Weinberger v. Kendrick, 698 F.2d 61. *Weight Watchers* does not preclude the approach I propose. That case, which was decided on a motion to dismiss the appeal, held nonappealable an order allowing defendant to conduct settlement discussions with members of a putative class; it did not deal with the issue of attorney's fees at all. The majority places undue reliance on dictum in that opinion, which suggests that Rule 23 does not prevent negotiations between defendants and individual members of a potential class. 455 F.2d at 773. Judge Friendly acknowledged, however, that a settlement with individual class members, who may compromise their individual claims and possibly dilute the class, differs from an offer to the class as a whole, which could moot the entire action. Id. at 773, 775.

Unlike the defendants in *Weight Watchers*, defendants in this case did not attempt to negotiate with individual potential class members. Instead, through the public tender offer defendants extended an offer to the entire putative class—an offer that effectively settled the case by mooting the entire action.[1] This is precisely the activity that Rule 23(e) was designed to control through judicial review and supervision. By circumventing that review and supervision, defendants violated Rule 23.

The district judge improperly relied on *Weight Watchers* to support her finding that Rule 23 cannot apply to defendants'

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1 I disagree with the majority's suggestion that defendants' tender offer was not a settlement offer simply because it was directed at a group of stockholders less broad than the plaintiffs' proposed class and for an amount less than plaintiffs demanded in their amended complaint. Except for minor variations due to stock transactions between the time of the merger and the tender offer, defendants' tender offer for all of the outstanding shares of Preferred and Series C stock encompassed the class of persons plaintiffs sought to represent. Moreover, it does not matter that defendants offered less than plaintiffs sought in their lawsuit because a settlement price is almost always somewhat less than the amount originally demanded. I also disagree with the majority's suggestion that the tender offer could not be a settlement unless plaintiffs were required to sign releases. Under a realistic view of the terms and timing of defendants' transaction, defendants' public tender offer was clearly a settlement offer directed at the plaintiff class.

settlement offer to plaintiffs' class. That case simply does not apply here. Indeed, when faced with this issue, this court has indicated that Rule 23(e) may be applied to dismissals or settlements agreed to before class certification. See Weinberger v. Kendrick, 698 F.2d at 73; Plummer v. Chemical Bank, 668 F.2d at 658. See also Robinson v. First National City Bank, 482 F. Supp. 92, 100 (S.D.N.Y. 1979); Jaen v. New York Telephone Co., 81 F.R.D. 696 (S.D.N.Y. 1979). As stated by then district judge Walter R. Mansfield in Gaddis v. Wyman, 304 F. Supp. 713 (S.D.N.Y. 1969):

> Defendants are not aided in their argument by the fact that a court has never determined that a class in fact exists, for 'during the interim between filing and [a determination concerning class certification, the lawsuit] must be assumed to be a class action for purposes of dismissal or compromise under 23(e) unless and until a contrary determination is made. . . .'

Id. at 715, quoting Philadelphia Electric Co. v. Anaconda American Brass Co., 42 F.R.D. 324, 326 (E.D. Pa. 1967) (citations omitted). Rule 23 does not apply only after a class has been certified. The Rule may also be relevant earlier if the court determines that the lawsuit would have been an appropriate class action.

The majority's approach is also inconsistent with the sound policy concerns. It conflicts with the important role of "private attorney general" played by attorneys for plaintiffs in class suits that was recognized by the Supreme Court in Deposit Guaranty National Bank v. Roper, 445 U.S. 326, 338 (1980). In contrast, permitting defendants to in effect settle an entire class suit and deprive plaintiffs' attorneys of fees as a matter of law will almost certainly deter attorneys from bringing class action lawsuits. Certainly, frivolous class suits should be discouraged but, as defendants' actions make clear, this class suit was not frivolous.

Finally, I do not believe that requiring defendants to subject these public offers to judicial supervision will discourage curative action or quick settlements. In deciding whether plaintiffs'

attorneys are entitled to fees the court can take into account how much, or how little, plaintiffs had to do in obtaining the settlement. Obviously, the sooner a defendant acts to satisfy plaintiffs' demands by paying the money offered into court, the lower the fees.

The outcome of this case depends on an analysis of policy views concerning class actions. In my view, the majority has followed the wrong policy. I would remand the case to the district court to allow it to consider whether it would have certified the class, whether the complaint would have withstood a motion to dismiss before defendants mooted the case, and whether the lawsuit was the proximate cause of any benefit to the class. If the answer to these questions is affirmative, I would expect the district court, in the exercise of its discretion, to award a reasonable fee under all the circumstances to be paid by defendants.

Memorandum Decision of the District Court dated October 9, 1985

UNITED STATES DISTRICT COURT

DISTRICT OF CONNECTICUT

Civil No. B-84-625 (EBB)

CHARLES C. CHRISTENSEN, ET AL

—v.—

KIEWIT-MURDOCK INVESTMENT CORP., ET AL

RULING ON PLAINTIFF'S REQUEST TO DISMISS THE ACTION AS MOOT AND FOR AN AWARD OF ATTORNEY'S FEES

Pending before the court is plaintiffs' request to dismiss this action as moot in view of a tender offer and cash-out merger made by defendant Kiewit-Murdock Investment Corporation (KMI). Plaintiffs also ask the court to retain jurisdiction of this action for purposes of considering plaintiffs' application for attorneys' fees and costs totalling $3,575,699. Defendants do not object to dismissal of the action as moot. They argue, however, that plaintiffs are not entitled to an award of attorneys' fees. For the reasons discussed below, the court concludes that the action should be dismissed as moot. Plaintiffs' request for an award of attorneys' fees and costs is denied.

A. Facts

This suit arises out of a merger of the Continental Group, Inc. into a subsidiary of KMI in November, 1984. Plaintiffs were holders of Continental Series C and Preferred stock prior

to the merger. In accordance with the terms of the merger, KMI paid cash for the Continental Series A, Series B and common stock. The Series C and Preferred shareholders, instead of receiving cash, received stock certificates in KMI Continental, the entity formed as a result of the merger. Plaintiffs commenced this action on September 21, 1984. An amended complaint was filed in January, 1985,[1] which alleged essentially that the defendants engaged in unlawful "manipulation" in violation of the federal securities laws by not cashing out the Series C and Preferred stock in the merger and by leaving plaintiffs with "speculative low grade, highly leveraged securities." The amended complaint also alleged that the defendants breached a fiduciary duty owed to plaintiffs "by burying Series C and Preferred investments, in debt ridden, private KMI Continental." By way of relief, plaintiffs sought a judgment declaring that the defendants violated the federal securities laws and breached their fiduciary duty. Plaintiffs also sought an order requiring the defendants to redeem the Preferred and Series C shares. In July, 1985, the defendants moved to dismiss the amended complaint. On September 17, 1985, plaintiffs filed their memorandum in opposition to the motion to dismiss. Oral argument on the motion to dismiss was scheduled for December 9, 1985. On October 1, 1985, KMI announced a tender offer for all of the oustanding shares of KMI Continental Preferred and Series C stock at $55.50 and $45.00 per share, respectively. Thereafter, KMI acquired approximately 86% of the KMI Continental shares and 77% of the Series C shares by way of the tender offer and proposed to acquire the remainder of the shares by merging a subsidiary of KMI with KMI Continental. In light of the tender offer, plaintiffs' counsel announced at the time of oral argument on the motion to dismiss that the case was moot. Counsel represented that the objective of the law suit had been accomplished by reason of KMI's cashing out of the Preferred and Series C shares, and indicated that the action should be dismissed with plaintiffs'

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1 The second amended complaint was filed by plaintiffs purportedly on behalf of the Continental Series C and Preferred shareholders. However, no class was ever certified in this case.

consent. Plaintiffs now maintain that the action is indeed moot; however, they argue that the court should retain jurisdiction for purposes of awarding plaintiffs attorneys' fees and costs. Defendants contend that, even if the case is dismissed as moot, plaintiffs are not entitled to an award of attorneys' fees.

B. Mootness

In view of the relief sought by plaintiffs, it is clear that the instant case must be dismissed as moot. Plaintiffs sought an order requiring the defendants to redeem the Continental Series C and Preferred shares. Counsel has indicated to the court that "the present value of being cashed out at $45 and $55.50 per share . . . is substantially equivalent to the relief plaintiffs sought in this action." *Plaintiffs' Memorandum of Law Supporting Dismissal of the Action, on Plaintiffs' Consent, as Moot* Paragraph 7(2). Therefore, it appears the facts alleged in the complaint have changed to such an extent that it would be fruitless for the plaintiffs to maintain the suit.

Furthermore, although this case was pleaded as a class action, the court agrees with the plaintiffs' contention that notice to the proposed class is not required. It has been decided that KMI's actions rendered plaintiffs' claims moot. The court having determined that dismissal of the action is required on that basis, notice under F.R. Civ. P. 23(e) is unnecessary. *See Daugherty v. Ball*, 43 F.R.D. 329, 336 (C.D. Cal. 1967); *Baham v. Southern Bell Tel. & Tel. Co.*, 55 F.R.D. 478, 479 (W.D. La. 1972).[2]

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2 The purpose of Rule 23 is to protect absent class members from prejudice in the event that class representatives seek to dismiss the suit or are able to reach some compromise of their individual claims. *See Moreland v. Rucker Pharmacal Co., Inc.*, 63 F.R.D. 611, 615 (W.D. La. 1974). In the instant case, there were no individual settlements or compromises involving class representatives. Rather, it appears that the claims of all the potential class members have been mooted by the change in factual circumstances. Notice, therefore, would serve no purpose.

C. Attorneys' Fees

Plaintiffs argue that, even if the case is dismissed as moot, the court should retain jurisdiction for purposes of considering plaintiffs' application for attorneys' fees and costs. Assuming that the court can retain jurisdiction as plaintiffs suggest, it appears that an award of attorneys' fees in this case is legally unwarranted.

Plaintiffs recognize the "American Rule" pertaining to attorneys' fees; i.e., that absent statutory authorization, a losing party may not be charged with the winning party's attorneys' fees. *See Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240 (1975). However, they rely on two exceptions to the American Rule in support of their claim.

Plaintiffs initially argue that they are entitled to an award of fees under the common fund doctrine. Under the common fund doctrine, "a litigant or a lawyer who recovers a common fund for the benefit of persons other than himself or his client is entitled to a reasonable attorney's fee from the fund as a whole." *Boeing Co. v. Van Gemert*, 444 U.S. 472, 478 (1980). Courts recognizing this doctrine have emphasized that it is designed to assess fees against the entire fund, "thus spreading fees proportionately among those benefitted by the suit." *Id. See also Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 396 (1970).

Plaintiffs argue that the "fund" created in this case was the amount paid by KMI for the Series C and Preferred stock as a result of the tender offer and merger. They maintain that the cashing out of the shares was a result of this lawsuit, that the holders of the Series C and Preferred stock benefitted from plaintiffs' actions and that plaintiffs are entitled to a percentage of the amount paid for the shares by KMI as an award of attorneys' fees and costs.

The award of fees that plaintiffs seek would not be payable out of any "fund", but would be taxed against the defendants directly. Plaintiffs have failed to offer an adequate justification for this approach under the common fund doctrine. As has been discussed, *supra*, the rationale behind the doctrine is that

fees should be spread among those benefitted by the suit. The cases cited by plaintiff do not indicate otherwise. In *Koppel v. Wein*, 743 F.2d 129 (2d Cir. 1984), on which plaintiffs place primarily reliance, the Second Circuit suggests that a fee award against two general partners may be appropriate where it would "result in a pass-through of such litigation costs to all the [partnership] participants." *Id.* at 135. An award of fees in this case would not "pass-through" to any of the stockholders affected by this lawsuit, but would in effect be a windfall for plaintiffs and would be payable by defendants in addition to the amount already paid for the shares. Such a result finds no support in the rules governing awards of attorneys' fees.

Plaintiffs also maintain that they are entitled to an award of attorneys' fees based on the "bad faith" exception to the American Rule. Plaintiffs apparently argue that the defendants' bad faith is evidenced by their "flagrant violation" of Rule 23 of the Federal Rules of Civil Procedure. Because the defendants made the tender offer during the pendency of this action and before a class was certified, plaintiffs contend that defendants avoided the creation of a common fund out of which an award of attorneys' fees could be made.

As previously discussed, and as the plaintiffs themselves have argued, the provisions of Rule 23 were not triggered in this action for purposes of giving notice to potential class members. It is difficult to understand how the same rule can be relied on in assessing the propriety of the defendants' conduct on a claim of bad faith. Rule 23 does not appear to apply in situations such as the present where, prior to the certification of a class, a defendant takes some action which has the effect of mooting the claims of potential class members. *See Moreland v. Rucker Pharmacal Co., Inc.*, 63 F.R.D. 611, 615 (W.D. La. 1974). *See also Weight Watchers of Philadelpha, Inc. v. Weight Watchers Int'l., Inc.*, 455 F.2d 770, 773 (2d Cir. 1972) (prior to certification of class, Rule 23(e) does not prevent defendant from settling individual claims with potential class members). Plaintiffs' claim that the defendants acted in bad faith by violating Rule 23 is therefore unavailing.

D. Conclusion

Plaintiffs' claims for relief having been satisfied by the tender offer and merger by KMI, this action is dismissed as moot. Plaintiffs' request for attorneys' fees and costs is without legal basis and is accordingly denied.

SO ORDERED.

ELLEN BREE BURNS

Ellen Bree Burns
United States District Judge

Dated at New Haven, Connecticut, this 9th day of October, 1986.

Order Denying Rehearing

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Docket No. 86-7964

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse, in the City of New York, on the 15th day of May one thousand nine hundred and eighty-seven

CHARLES S. CHRISTENSEN and JENNE CHRISTENSEN, Joint Tenants; ALTIE L. CLARK and LENA F. CLARK, Joint Tenants; JOHN C. ECHON, Individually and as Joint Tenant with LILLIAN ECHON; JAMES M. HOSS, JR., and MARIAN C. HOSS, Joint Tenants; HENRY B. HOSS; DAVID C. KRISER; PENNSYLVANIA NATIONAL MUTUAL CASUALTY INSURANCE COMPANY,

Plaintiffs-Appellants,

—v—

KIEWIT-MURDOCK INVESTMENT CORPORATION, PETER KIEWIT SONS, INC., PACIFIC HOLDING CORPORATION, KMI CONTINENTAL INC., THE CONTINENTAL GROUP, INC., S. BRUCE SMART, JR., DAVID H. MURDOCK, RAYMOND F. HENZE, III, WALTER SCOTT, JR., DONALD L. STURM,

Defendants-Appellees.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the Appellants CHRISTENSEN et al

Upon consideration by the panel that heard the appeal, it is

Ordered that said petition or rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

Elaine B. Goldsmith

ELAINE B. GOLDSMITH

Clerk

Judgment of the District Court

UNITED STATES DISTRICT COURT

DISTRICT OF CONNECTICUT

Civil B-84-625 (EBB)

CHARLES C. CHRISTENSEN, et al

KIEWIT-MURDOCK INVESTMENT CORP. et al

JUDGMENT

This cause came on for consideration on plaintiffs' request to dismiss the action as moot and for an award of attorney's fees by the Honorable Ellen Bree Burns, United States District Judge, and

The Court having considered the motion and all the papers submitted in connection therewith dismissed the action as moot and further ruled that plaintiffs' request for attorneys' fees and costs is without legal basis and accordingly denied,

It is therefore ORDERED and ADJUDGED that the action is dismissed as moot and plaintiffs' request for attorneys' fees and costs is denied.

Dated at Bridgeport, Connecticut this 14th day of November, 1986.

KEVIN F. ROWE, Clerk

By CAROLE E. CANNADY
Carole E. Cannady
Deputy in Charge

UNITED STATES DISTRICT COURT

DISTRICT OF CONNECTICUT

Civil Action No. B84-625 (EBB)

CHARLES S. CHRISTENSEN and JENNE CHRISTENSEN, Joint Tenants; ALTIE L. CLARK and LENA F. CLARK, Joint Tenants; JOHN C. ECHON, individually and as Joint Tenant with LILLIAN ECHON; JAMES M. HOSS, JR. and MARIAN C. HOSS, Joint Tenants; HENRY B. HOSS; DAVID C. KRISER; PENNSYLVANIA NATIONAL MUTUAL CASUALTY INSURANCE COMPANY,

Plaintiffs,

—against—

KIEWIT-MURDOCK INVESTMENT CORPORATION, PETER KIEWIT SONS, INC., PACIFIC HOLDING CORPORATION, KMI CONTINENTAL INC., THE CONTINENTAL GROUP, INC., S. BRUCE SMART, JR., DAVID H. MURDOCK, RAYMOND F. HENZE, III, WALTER SCOTT, JR., DONALD L. STURM, FLETCHER L. BYROM, DONALD J. DONAHUE, STEPHEN M. DUBRUL, JR., JACK S. PARKER, FRANK H. T. RHODES, DONALD V. SEIBERT, LUCY WILSON BENSON, COLBY H. CHANDLER, DON JOHNSTON, PETER G. PETERSON, and C. EDWARD ACKER,

Defendants.

AMENDED CLASS ACTION COMPLAINT

Plaintiffs above named, by their attorneys, allege upon information and belief, except for paragraphs 1(2) and 6 through 8, which are alleged upon knowledge, as follows:

NATURE OF ACTION

1. This class action under Section 10(b) of the Securities Exchange Act of 1934 (the " '34 Act"), and Rule 10b-5 of the Rules and Regulations of the Securities and Exchange Commission thereunder, and under the common law, for a declaratory judgment, mandatory injunction, and to impress a constructive trust:

(1) *Is commenced* on behalf of the beneficial owners of 1,583,845 shares of the $4.50 Cumulative Preference Stock, Series C (the "Series C") of The Continental Group, Inc., ("Continental"), and the beneficial owners of 50,624 shares of Continental's $4.25 Cumulative Preferred Stock (the "Preferred").

(2) *Is brought* on behalf of the Series C, by all of the Plaintiffs—other than Plaintiff David C. Kriser ("Kriser")—who were each Series C shareholders when the merger, which precipitated this litigation, was announced and consummated; and on behalf of the Preferred, by Plaintiff Kriser, who likewise was a Preferred shareholder on both dates.

(3) *Is the result* of the consummation of the $2.9 billion leveraged buy-out merger of Continental into KMI Continental Inc. ("KMI Continental"), under which KMI Continental is being dismantled, through asset sales of one billion dollars and two billion dollars in restrictive loans (the "LBO Merger"), to finance the cash out merger of Continental's Common Stock ("Common Stock"), Series A Preference Shares ("Series A"), and Series B Preference Shares ("Series B").

(4) *Was provoked* by the defendants' forcing the owners of the Series C and of the Preferred, to exchange them for those of KMI Continental, so that the Series C and Preferred Shares are junior to nearly $2.7 billion in debt—compared to pre-LBO Merger debt of only $726 million—thereby transforming the intrinsic nature of the Series C and Preferred from long term, quality invest-

ments in a top rated public company, into low grade, inferior quality securities of a highly leveraged, private company whose ability to pay interest on its senior debt is speculative, and causing diminished market interest in buying and selling those securities.

(5) *Is against* Continental and its directors, KMI Continental, Continental's former Chief Executive Officer, the leveraged buy-out owners of KMI Continental and their four director designees.

(6) *Seeks relief*, declaring that the defendants have manipulated the nature of the investment instruments represented by the Series C and the Preferred, drastically depreciating them and their marketability, by transforming them from sound, quality, long term, fixed return investments in a substantial public company, marketable at fair value, into speculative, low grade, securities of a highly leveraged private company—to the irreparable injury of their owners, in violation of Section 10(b) and Rule 10b-5, and the common law of the State of New York, and thereby entitling them to a mandatory injunction to compel their redemption.

JURISDICTIONAL ALLEGATIONS

2. This action arises as a result of violations of rights arising under Section 10(b) of the '34 Act, 15 U.S.C. Section 78j(b), and Rule 10b-5, 17 C.F.R. Section 240.10b-5; and breaches of the common law, including fiduciary duties owed by officers, directors and majority shareholders to the public shareholders of their companies.

3. This Court has jurisdiction over the subject matter of the action under the '34 Act, 15 U.S.C. Sections 77v, 78aa; by virtue of diversity of citizenship under 28 U.S.C. Section 1332, the amount in controversy being in excess of $10,000, exclusive of interest and costs; and by the principles of pendent jurisdiction.

4. Venue is proper under Section 27 of the '34 Act, 15 U.S.C. 78aa, and 28 U.S.C. Section 1391, 1401, in that the principal business offices of Continental and its KMI Continental successor, are located, and many of the acts complained of had their origin, in this district.

5. The acts complained of involve the use of instrumentalities of interstate commerce and the mails.

PLAINTIFFS

6. Plaintiffs bring this action individually and on their own behalf, and representatively as a class action, pursuant to Rule 23 of the Federal Rules of Civil Procedure, on behalf of the persons comprising the beneficial owners on June 29, 1984, and their successors, of the Series C ("Series C Class"), and of the Preferred ("Preferred Class"), excluding from both Classes the defendants and their families.

Series C Class

7. The following plaintiffs beneficially owned Series C when the LBO Merger was announced on June 29, 1984, and prior thereto and for which certificates of KMI Continental have been substituted, and, (unless otherwise noted) each received some of their shares in exchange for Common Stock of Florida Gas Company ("Florida Gas"), when Florida Gas was acquired by Continental in September, 1979:

(1) Plaintiffs Charles S. Christensen and Jenne Christensen, citizens of the State of Florida, joint tenants, *2,500 shares*.

(2) Plaintiffs Altie L. Clark and Lena F. Clark, citizens of the State of Florida, joint tenants, *443 shares*.

(3) Plaintiffs John C. Echon and Lillian Echon, citizens of the State of Florida, joint tenants, *1097 shares*, and John C. Echon, individually, *87 shares*.

(4) Plaintiffs James M. Hoss and Marion C. Hoss, citizens of the State of Oklahoma, joint tenants, *921 shares*.

(5) Plaintiff Henry B. Hoss, citizen of the State of Oklahoma, 74136, *100 shares*.

(6) Plaintiff Pennsylvania National Mutual Casualty Insurance Company, a Pennsylvania corporation, with its principal office located at 1900 Dairy Street, Harrisburg, Pennsylvania, *12,000 shares*.

Preferred Class

8. Plaintiff Kriser, a citizen of the State of Illinois, beneficially owned Preferred when the LBO Merger was announced on June 29, 1984, and prior thereto, for which certificates of KMI Continental have been substituted, *879 shares*.

CORPORATE DEFENDANTS

A. *Continental*

9. Defendant Continental, at all times to and including its merger into KMI Continental:

(1) Was a corporation incorporated under the laws of the State of New York, with its corporate headquarters and principal place of business located at One Harbor Plaza, Box Number 10129, Stamford, Connecticut 06904-2129.

(2) Was engaged principally in the packaging, insurance, forest products, and energy businesses.

(3) Had outstanding on June 29, 1984, the following securities:

Common Stock	42,622,297 shares
Series A Preference ..	6,220,741 shares
Series B Preference...	243,630 shares
Series C Preference ..	1,583,845 shares
Preferred	50,624 shares
Total	50,721,137 shares

(4) Caused the Series C to be issued, as an original issue, to the holders of Common Stock of Florida Gas—who had no right of appraisal—in the 1979 merger of Florida Gas into Continental.

(5) Caused the Common, the Series A and the Series C to be listed and principally traded on the New York Stock Exchange; there was no established trading market for the Series B and the Preferred was thinly traded on the over-the-counter market ("OTC"); and the Series A and the Series B were convertible into Common Stock, but the Series C and the Preferred were not.

(6) The principal features of the Series C and the Preferred which, like the Common, the Series A and the Series B, were equity securities, included the following:

> *Series C*: $4.50 per share annual dividends; liquidation preference of $50 per share; redeemable upon voluntary liquidation of Continental at Continental's election beginning June 30, 1987 at $53.55 per share, reduced by approximately .12 per share per year until reaching $50.12 in the year 2010, and $50 thereafter.
>
> *Preferred Stock*: $4.25 per share annual dividends, redeemable upon voluntary liquidation of Continental, or at Continental's option, at $110 per share. Continental may purchase up to 3,000 shares a year at public or private sale with or without advertisement.

(7) Had 1983 revenues of $5.5 billion and net earnings of $199 million, stockholders equity of $1,532 billion and $726 million in long term debt.

(8) Was merged into KMI Continental on November 1, 1984 in a $2.9 billion leveraged buy out (the "KMI-LBO Merger"), pursuant to the Amended and Restated Agreement and Plan of Merger, dated June 29, 1984, with the other corporate defendants (the "KMI-LBO" Merger Agreement").

B. *KMI-LBO Corporations*

10. The KMI-LBO Merger Agreement involved the leveraged buy out of Continental by (or through) the following corporations, (jointly called the "KMI Corporations"): defendant Kiewit-Murdock Investment Corporation, a Delaware corporation ("KMI"), which is 80% owned by defendant Peter Kiewit Sons, Inc., a Delaware Corporation ("Kiewit"), and 20% owned by defendant Pacific Holdings Corporation, a Delaware Corporation ("PHC"); and since November 1, 1984, defendant KMI Continental, a New York Corporation, and a wholly owned subsidiary of KMI, with the same principal offices as Continental has succeeded to all of Continental's business and assets, and sent to Plaintiffs and members of both Classes, and their successors, "Instructions for receiving New Series C and New Preferred Stock of KMI Continental Inc.", and is issuing KMI Continental Certificates in exchange for their Continental Certificates.

C. *Director Defendants*

11. Defendant S. Bruce Smart, Jr., ("Smart"), a citizen of Connecticut, was in effective control of the management and affairs of Continental, and the Continental Board of Directors accepted and acquiesced in his leadership. Defendant Smart was Chairman and Chief Executive Officer of Continental to and including June 29, 1984 and he continued as such until Continental's merger into KMI Continental, when he assumed the same offices, until his resignation, effective December 31, 1984.

12. When the KMI-LBO Merger Agreement was approved, the Continental Board of Directors, in addition to defendant Smart, consisted of defendants Fletcher L. Byrom (a citizen of the State of Colorado), Donald J. Donahue (a citizen of the State of Connecticut), Stephen M. DuBrul, Jr. (a citizen of the State of New York), Jack S. Parker (a citizen of the State of Connecticut), Frank H.T. Rhodes (a citizen of the State of New York), Donald V. Seibert (a citizen of the State of New Jersey),

Lucy Wilson Benson (a citizen of the State of Massachusetts), Colby H. Chandler (a citizen of the State of New York), Don Johnston (a citizen of the State of Connecticut), Peter G. Peterson (a citizen of the State of New York) and C. Edward Acker (a citizen of the State of New York), (jointly "Continental Directors").

13. Pursuant to the KMI-LBO Merger Agreement, PHC designated defendants David H. Murdock and Raymond T. Henze, III, citizens of the State of California, and Kiewit designated Walter Scott, Jr. and Donald L. Storm, citizens of the State of Nebraska, as Continental directors; they were elected to the Continental Board of Directors on June 29, 1984, serving continously until the KMI-LBO Merger and are now KMI Continental directors (the "KMI-Directors").

CLASS ACTION ALLEGATIONS

14. This action is properly maintainable as a class action under Rule 23 of the Federal Rules of Civil Procedure, in that the Classes consist of the Series C Class, comprising more than 10,000 beneficial owners of Series C Shares, and the Preferred Class, comprising more than 400 beneficial owners and their successors, of Preferred Shares (collectively the "Classes"); each are scattered throughout the United States; and each are so numerous that the joinder of all members of each Class is impractical.

15. All Plaintiffs are members of the Series C Class, except Plaintiff Kriser, who is a member of the Preferred Class. Each Plaintiff (a) has claims typical of all members of his Class; (b) has sustained substantial losses as a result of the conduct of the Defendants; (c) is committed to pursuing this action; (d) has retained competent counsel experienced in litigation of this nature; (e) has no interest in conflict or inconsistent with the interest of any member of the Class or each other; and (f) will fairly and adequately protect the interests of the Classes.

16. There are questions of law and fact common to the members of each Class, and to both Classes, which predominate over any questions affecting individual members of either Class, and each Plaintiff's claims are typical of the claims of all members of both classes, which include whether:

(1) The acts of the KMI Corporations, in selling off a third of Continental's assets, borrowing against the other two-thirds, and diverting its cash flow to pay the debt charges to finance the KMI-LBO Merger, aided and abetted by the Continental and KMI Directors, manipulated the intrinsic nature of the Series C and Preferred instruments and the market therein, drastically depreciating them and their resaleability, in violation of Section 10(b) and Rule 10b-5, and the common law of the State of New York.

(2) Through said sales and borrowings against all or substantially all of Continental's assets, the KMI Corporations, aided and abetted by the Continental and the KMI Directors, manipulated the nature of the Series C and of the Preferred, diminishing the market's interest in buying and selling them, by transforming them from sound, quality, long term, fixed return investments in a substantial public company, into speculative, low grade, poor quality securities of a highly leveraged, credit risk private Company, in violation of Section 10(b) and Rule 10b-5.

(3) The course of conduct of the KMI Corporations and the KMI Directors, aided and abetted by the Continental Directors: constitutes a liquidation of Continental and therefore a breach of the rights of the members of both Classes, under the Continental Certificate of Incorporation, entitling them to redemption of their securities; and a "looting" of all or substantially all of Continental's assets entitling the members of both Classes to dissolution under the common law of New York, or its equivalent in this case, redemption.

(4) The Continental Directors, at all times herein, and KMI and the KMI Directors since June 29, 1984, breached their fiduciary obligations to the members of each Class by failing to redeem the Series C or at least cause the Series C Shares to be cashed out in the KMI-LBO for at least the $45 per share offered in the Diamond Proposal as hereinafter alleged, and by failing to redeem the Preferred.

17. The prosecution of separate actions by individual members of the Classes would create a risk of inconsistent and varying adjudications; a class action is superior to other available methods for the fair and efficient adjudication of this controversy; the Defendants, by their consummation of the KMI-LBO Merger and through the Merger Prospectus (hereafter described) which disclosed its consequences, have acted on grounds generally applicable to both Classes, thereby making appropriate final equitable relief with respect to each Class as a whole, as prayed for in this Amended Complaint; and the claims as they affect each entire Class, are best managed in one action, and can be adjudicated with dispatch in this district where KMI Continental is located, and where many of the acts complained of originated or occurred.

THE KMI-LBO MERGER AGREEMENT

18. On June 29, 1984, the Continental Directors approved, and entered into the KMI-LBO Merger Agreement, embodying the KMI-LBO Merger. The KMI-LBO Merger was conditioned upon Continental causing the KMI Directors to be appointed to Continental's Board of Directors, concurrently with the execution of the KMI-LBO Merger Agreement, and they were elected on June 29, 1984, continuing as Continental (and since November 1, 1984, as KMI Continental), directors ever since.

19. Continental, the Continental and KMI Directors, KMI, Kiewit and PHC, caused to be issued to all Continental shareholders, including Plaintiffs and the members of both Classes, a combination Proxy Statement/Prospectus, dated

August 27, 1984 (the "Merger Prospectus"), for a special stockholders meeting which was held on Wednesday, September 6, 1984 (the "Merger Meeting"), and which approved the $2.9 billion leveraged buy-out merger of Continental into KMI Continental, under which:

(a) The Common, the Series A and the Series B were cashed out for $58.50 per share, $29.25 per share and $43.87 per share, respectively (the "Cashed Out Securities"), while the Series C and the Preferred were paid nothing.

(b) The Series C and the Preferred were compelled to exchange their securities for private KMI Continental certificates.

(c) The Common Stock, with one vote each, had nearly 85% of the combined two-thirds vote of the Common, Series A, Series B and Series C, required to approve the merger, and which was obtained; (the Series A and the Series B had 3/8 of a vote each, the Series C, 3/4 of a vote, but the Preferred was not entitled to vote at all).

FINANCING THE KMI-LBO: $2.8 BILLION OF CONTINENTAL DEBT

20. Even before the KMI-LBO Merger was consummated, a Continental lender objected that the KMI-LBO debt was so great that it would violate its loan arrangements, so the lender compelled Continental to prepay $184.5 million of long-term debt, bearing interest rates from 4% to 9%, at a prepayment interest cost of approximately 13% to 14% (Merger Prospectus, p. 13).

21. According to the Merger Prospectus, KMI Continental is using all or substantially all of Continental's assets and credit to finance the KMI-LBO Merger, including:

(1) *$2 billion* under a highly restrictive credit agreement with nineteen domestic and foreign banks (the "KMI Facility") which KMI required to repay the KMI-LBO Merger debt (p.12).

(2) $1 billion in sales of Continental assets and businesses to repay the KMI-LBO Merger debt.

(3) *A Substantial Portion of KMI Continental's Cash Flow, to Service the Debt.*

(4) Reducing the KMI Facility borrowings by $.5 billion within 6 months; by a total of $1 billion within 12 months and after 18 months, by semi-annual repayments of $125 million until all debt is paid within 5 years.

22. As a result of the KMI-LBO Merger:

(1) Continental's debt to asset ratio—$708 million to $1.5 Billion—will be triple reversed, into debt of $2.638 Billion and assets of only $758 million (p. 37).

(2) $230 million in pro forma earnings deficiency, will be created (as of December 31, 1983), (p.32).

THE DISCREDITED SERIES C AND THE PREFERRED: BURIED IN DEBT

23. The members of both Classes were advised by letter, dated November 1, 1984, on the letterhead of KMI Continental, signed by Defendant Smart, that the KMI-LBO Merger, had been consummated on that date.

24. Since November 1, 1984, KMI Continental—privately owned by KMI—has succeeded to Continental's business, assets and credit, which it has disposed of and borrowed against, and is disposing of and borrowing against, in the manner and with the consequences alleged in paragraphs 20-22 hereof.

25. Prior to June 29, 1984, Standard & Poor's, which makes corporate debt rating assessments of the credit worthiness of corporate obligors, had given the approximately $708 million Continental senior debt, an "A" rating, which it defines as follows:

"A" *An issue rated "A" is backed by a sound capacity to pay interest and repay principal,* although it is some-

what more susceptible to the adverse effects of changes in circumstances and economic conditions."

26. The Standard & Poor's corporate debt credit rating, immediately below "A," is triple B, and it reads as follows:

> "BBB" *Debt rated "BBB" is regarded as having an adequate capacity to pay interest and repay principal.* Whereas it normally exhibits adequate protection parameters, *adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity to pay interest and repay principal for debt* in this category than in higher rated categories." (emphasis supplied)

27. Below "BBB," and two grades below "A," Standard & Poor's groups together "BB," "B" and "CC," as follows:

> "BB", "B", "CCC", "CC" *Debt rated "BB" "B", "CCC" and "CC" is regarded, on balance, as predominately speculative with respect to capacity to pay interest and repay principal* in accordance with the terms of the obligation. "BB" indicates the lowest degree of speculation and "CCC" the highest degree of speculation. While such debt will likely have some quality and protective characteristics, these are outweighed by large uncertainties or major risk exposures to adverse conditions." (emphasis supplied)

28. As a result of the KMI-LBO Merger asset sales and debt, and their effect on KMI Continental's credit and its ability to meet its obligations:

Standard & Poor's struck down KMI Continental's corporate debt rating, on November 16, 1984, from "A", reducing it by two grades, to "BB":

> "* * * *predominately speculative with respect to capacity to pay interest and repay principal* in accordance with the terms of the obligation . . . ."

29. The Series C and the Preferred—which in Continental were junior to Continental's "A" rated senior debt—are now, of course, junior to KMI Continental's predominately speculative capacity to pay interest and repay principal on its nearly $2.7 billion of debt.

30. The KMI-LBO merger debt is so great that, according to the merger Prospectus, KMI may not be able to pay the Class Members their dividends or cause KMI Continental to fulfill its redemption and repurchase obligations, because:

> (1) *Pro forma earnings, as defined, are inadequate to cover combined fixed charges and preferred and preference stock dividend requirements*, if the $2 billion borrowed under the KMI Facility remains outstanding throughout the period (p. 32). (emphasis supplied).
>
> (2) *90% of net proceeds* from sales of assets to third parties (whether before or after the merger) must be used to repay KMI Facility loans or for the prepayment of existing debt (p.13).
>
> (3) Although there are no KMI Facility restrictions, *dividends on preferred and preference stock may not be paid if payment would result in KMI's inability to meet the consolidated net worth and cash flow tests set forth in the KMI Facility* (p.31,32). (emphasis supplied).

GENESIS OF THE KMI-LBO MERGER

A. *Background*

31. The Merger Prospectus describes (p. 6) the following sequence of events which led ultimately to the KMI-LBO Merger:

> (1) On June 5, 1984, Continental's Board Chairman, Defendant Smart, received an unsolicited telephone call from the Board Chairman of Diamond Lands Corporation ("Diamond")—followed the next day by a letter—expressing an interest in a Continental-Diamond

combination involving the payment of $50 per share in cash for Continental's common stock (the "Diamond Proposal").

(2) Continental's Board met the next day and authorized management to talk to Diamond, and to explore other alternatives.

(3) Shortly thereafter, Continental retained Goldman Sachs and Co. ("Goldman Sachs") and Morgan Stanley & Co. Incorporated ("Morgan Stanley"), to act as financial advisors in response to the Diamond Proposal.

(4) Between June 6, 1984, and June 29, 1984, discussions ensued between Continental and Diamond, and others.

(5) On June 22, 1984, Diamond increased its proposal to $55 per share; the Continental Board rejected it; and was told by the financial advisors that greater value could probably be obtained by a merger, leveraged buyout, liquidation or sale of all or substantially all of Continental's assets.

B. *The Diamond-KMI LBO Merger Offers*

32. On June 29, 1984, the Continental Board considered a further proposal from Diamond and a proposal from KMI which, *inter alia*, compare as follows:

	Per Share		*Aggregate Payment*	
	Diamond	*KMI-LBO*	*Diamond*	*KMI-LBO*
Series C	$45	None	$ 71,273,025	None
Preferred	None	None	None	None
Common	$58	$58.50	$2,472,093,226	$2,493,404,375
A	$29	$29.25	180,401,489	181,956,674
B	$43.50	$43.875	10,597,905	$10,689,266
		Total:	$2,734,365,645	$2,686,050,315

33. Under the KMI Proposal, Continental shareholders would—and actually did—receive, in the aggregate, $48,315,330 *less* than under Diamond's, even though the common shareholders were to be paid fifty cents a share more, the Series A, twenty-five cents more, and the Series B, $.375 more

Because

Diamond offered $45 a share for the Series C, while KMI offered them nothing.

SERIES C—PREFERRED STOCK CONTRACTS RIGHTS

34. The Certificates of Incorporation of Continental and KMI Continental, with respect to the Series C and the Preferred, are identical (jointly the "Certificates").

35. *Series C.* Paragraph 5 of the Certificates, with respect to the Series C, provides that the holders shall be entitled:

> "In the event of liquidation, dissolution or winding up of the affairs of the corporation, whether voluntary or involuntary"

to be paid in cash the applicable liquidation price per share fixed at the time of the original issuance, before any distribution to the common stock or classes junior to the Series C.

36. *Preferred.* Paragraph 10 of the Certificates, with respect to the Preferred, provides that the holders shall be entitled:

> "In the event of any voluntary liquidation, dissolution or winding up of the affairs of the corporation"

to be paid in full the respective amounts which they would be entitled to receive if the shares had been redeemed on the liquidation date.

37. According to the Merger Prospectus:

> "By voting for and adopting the Merger Agreement, stockholders will, for federal income tax purposes, be approving the adoption of a plan of liquidation under Section 337 of the Internal Revenue Code of 1954" (p.8)

FAIRNESS OF KMI-LBO MERGER

38. Goldman Sachs and Morgan Stanley were paid by Continental $10.8 million for their opinion that the KMI-LBO Merger was fair to the Cashed Out Securities; but neither Goldman Sachs nor Morgan Stanley were asked for their opinion as to whether the KMI-LBO Merger was fair to the Series C and Preferred Shares.

39. No independant opinion was obtained as to the fairness of the KMI-LBO to the Series C or Preferred Shares.

40. According to the Merger Prospectus, on August 22, 1984, the trustees of the Savings Plan of Continental Group Resources Company (the "Trustees"), held 18,785 shares of Series C, on behalf of plan participants—Continental Employees.

41. Apparently, the Trustees did not obtain an independent opinion as to the fairness to the Series C of the KMI-LBO Merger, inasmuch as the Merger Prospectus does not contain any reference to such an opinion, nor to any effort to obtain one.

FIRST CLAIM

42. Plaintiffs repeat and reallege each and very allegation contained in paragraphs 1 through 41, as if fully set forth herein.

43. This First Claim arises under Section 10(b) of the '34 Act, and Rule 10b-5 thereunder, which make it unlawful, in connection with the purchase or sale of a security, as in the KMI-LBO Merger, to employ any manipulative or deceptive device or scheme or artifice to defraud, or to engage in any act, practice or course of business which operates or would operate as a fraud or deceit.

44. When the Continental Directors, on June 29, 1984, approved the KMI-LBO Merger Agreement requirement that the KMI Directors be then elected to the Continental Board,—

prior to stockholder approval and without full disclosure to the members of both Classes and to the market for the Series C and the Preferred—they thereby deliberately, knowingly and wilfully: (1) Turned over an effective control of Continental to KMI, the KMI Corporations and the KMI Directors which they have continously exercised ever since, (2) Permitted, encouraged and caused the creation, of the KMI-LBO Merger debt machinery, in advance of the statutorily required Stockholders' approval of the Merger, (3) Initiated a manipulative scheme and course of conduct to defraud Plaintiffs and the Class members of the securities they contracted for and owned, in violation of Section 10(b) and Rule 10b-5.

45. Continental, the Continental and KMI Directors, and the KMI Corporations, each knew that their failure to cash out the Series C and the Preferred, as they were cashing out the Common Stock, the Series A and the Series B, would, as it did:

(1) Submerge the Series C and the Preferred into the privately owned KMI Continental, with debt so great that its credit rating would be far lower and far more speculative than Continental's.

(2) Diminish the interest of the market in buying and selling the Series C and the Preferred and depreciate their re-saleability.

(3) Radically change the nature of the Series C and the Preferred as investment instruments, transforming them from sound, quality, long term, fixed return, investments in an established public company, into speculative, low grade, securities of inferior quality, in a highly leveraged private company; and

(4) Create a materially adverse and depressing effect upon the marketability and market price of the Series C and the Preferred.

46. In order to save KMI the approximately $90 million required to redeem the Series C and the Preferred, Continental, Smart, KMI, the KMI Directors and the KMI

Corporations—knowingly, deliberately and wilfully aided and abetted by the Continental Directors—knowingly, deliberately and wilfully committed the acts herein alleged, and they knew or should have known that each separate act would alone have a destructively manipulative effect—and in combination, all the more so—on the intrinsic nature of the preferred debt instruments represented by the Series C and the Preferred, of the marketability thereof and the market therefore, and upon the ability of the members of both Classes to sell them for fair value, including, *inter alia*:

(1) Causing effective control of Continental to be turned over to the KMI Corporations and the KMI Directors, on June 29, 1984, and initiating the KMI LBO long before its submission to and approval by shareholders, as required by law.

(2) Creating the KMI-LBO Merger to such a highly leveraged degree, that Standard & Poor's reduced Continental's debt credit rating to speculative "BB".

(3) Selling and borrowing against all or substantially all of Continental's assets, to finance the KMI-LBO Merger.

(4) Transforming Continental's $708 million in long term debt—when it had $1.5 billion in assets—into $2.638 billion in debt and only $758 million in assets.

(5) Failing and refusing to at least cause the Series C holders to receive the same price in the KMI-LBO Merger as Diamond offered, thereby directly resulting in a market price drop of $4 per share between June 29 and August 24 1984.

(6) Making and causing to be made, in the Merger Prospectus, the adverse market conditioning statements herein alleged.

(7) Failing to obtain an independent opinion as to the fairness of the KMI-LBO Merger to the members of the Series C and the Preferred Classes, and apparently acquiescing in the failure of the Trustees to do likewise.

47. The asset sales and restrictive debt obligations involve a voluntary liquidation of Continental, within both the meaning and intent of the Continental Certificate of Incorporation, and of the members of each Class when they purchased their securities with the understanding that they would be redeemed in the event of a voluntary liquidation.

48. In the investment community, the KMI-LBO asset sales and restrictive debt obligations, comprise acts which together are understood to be equivalent to a voluntary liquidation of all or substantially all of Continental's assets, coming within the parameters of the standard preferred stock voluntary liquidation clauses such as those in the Certificates, and the failure of the KMI Corporations to pay the members of each Class their respective liquidation redemption price, is a manipulative device and scheme to defraud, in violation of Section 10(b) and Rule 10b-5.

49. With respect to the Diamond Proposal, and the KMI-LBO Merger, the relevant Series C closing market prices on the New York Stock Exchange, were:

(1) *$36 per share* on June 4, 1984, the last full trading day before the first Diamond Proposal was announced.

(2) *$38 per share* on June 29, 1984, the last full trading day before the announcement of the KMI LBO.

(3) *$34.50 per share* on August 24, 1984, the last full trading day prior to the printing of the Merger Prospectus.

50. All of the Defendants knew or should have known, that the failure of the KMI-LBO Merger Agreement to provide for the cashing out, and the failure to cash out the Series C, would cause the Series C market price to drop, as it did.

51. The Defendants caused the Merger Prospectus to adversely condition the market for the Series C and the Preferred as long term, fixed return, quality investments, by negative

statements about them and their prospects for future dividends, including, *inter alia*:

(1) "*The Board recognized that the consummation of the Merger would not provide Continental Group's present equity holders with the chance to participate in any of the future earnings or growth of the Surviving Corporation.*

(2) "*The Board also considered*, with respect, to the Series C Preference Stock and the Preferred Stock, *that the Surviving Corporation would be required to borrow approximately $2 billion to effect the Merger and, on a pro forma basis, would not have sufficient earnings to cover dividends on such stocks without the repayment of acquisition related debt through sales of assets and businesses.*

(3) *In order to finance the $2 Billion Merger Loan the Defendants are going to sell off "approximately $1 Billion of assets and businesses . . . to repay borrowings xxx and to pay dividends . . . "on the Series C and the Preferred.*

(4) " * * * *such dividends may not be paid if the payment thereof would result in KMI's inability to meet the consolidated net worth and cash flow tests set forth in the KMI Facility.*"

(5) " * * * *pro forma earnings, as defined, are inadequate to cover combined fixed charges and Preferred and Preference Stock dividend requirements if the $2 billion borrowed under the KMI Facility remains outstanding throughout the period * * * and the amount of the pro forma earnings deficiency is approximately $230 million* * * * "

52. On January 15, 1985 the Series C closed at $35.875 on the N.Y. Stock Exchange,—with only 200 shares traded—while the Preferred bid price, on the OTC was $31.

53. In the past approximately four months, as interest rates have dropped:

(1) The market prices of corporate securities, comparable to the Continental Series C and Preferred, have increased.

(2) The markets for the KMI Continental Series C and the Preferred, have been relatively inactive and their prices, unaffected by the substantial drop in interest rates, remained substantially the same.

54. But for the KMI-LBO merger, the markets for the Series C and the Preferred would have maintained their historic activity and their prices would have reflected the change in interest rates.

55. By reason of the foregoing:

(1) The Defendants' conduct, constitutes a deliberate and willful manipulative scheme, device and course of conduct, which manipulated and depreciated the inherent nature of the Series C and the Preferred instruments, their long and short term values, the markets therein, the marketability thereof and the market prices therefore, diminishing the market's interest in buying and selling them, in violation of Section 10(b) and Rule 10b-5, entitling Plaintiffs and the Classes to a declaratory judgment to that effect; and

(2) Plaintiffs have been irreparably injured and are entitled to redemption of their Series C and Preferred securities.

56. Plaintiffs have no adequate remedy at law.

SECOND CLAIM

57. Plaintiffs repeat and reallege each and every allegation contained in paragraphs 1 through 41, and 44 through 55, as if fully set forth herein.

58. This second claim arises under the common law of the State of New York, where Continental is incorporated, as to which this Court has diversity and pendent jurisdiction.

59. At all times herein, the Continental Directors, and since June 29, 1984, the KMI Directors and KMI Corporations, have been constituted guardians of Continental's corporate welfare, cast in the role of fiduciaries, who were in effective control of Continental and, under New York law, required to exercise their responsibilities as such with scrupulous good faith.

60. The unique discriminatory unfairness of the KMI-LBO Merger, to the members of both Classes, is exemplified by the actions of the Continental Directors in applying Continental's business, assets and credit—in which the members of both Classes have an equitable interest—for the benefit, in every instance, of Smart and Continental's Management, and the Cashed Out Securities owners:

For The Common	$2,493,404,374
For The A	$ 181,956,674
For The B	$ 10,688,827
For Officers, Directors and Employees	$ 35,000,000
For Financial Advisors ...	$ 10,800,008
For Prior Debt	$ 184,500,000
Grand Total.....	$2,916,349,875

while at the same time

THE CONTINENTAL DIRECTORS, AIDED AND ABETTED BY THE KMI DIRECTORS AND THE KMI CORPORATIONS, SUNK THE SERIES C AND PREFERRED EQUITY OWNERS IN A DEBT RIDDEN, "BB", SPECULATIVE, PRIVATELY OWNED, VESTIGIAL CORPORATE REMAIN OF THEIR ORIGINAL "A" BOND RATED COMPANY.

61. By virtue of their acts and course of conduct herein alleged, the KMI Corporations, aided and abetted by the Continental Directors, and the KMI Directors, deliberately and wilfully used the KMI-LBO Merger Agreement to maintain the business, assets and credit of Continental solely for their own benefit, at the expense of the Series C and Preferred sharehold-

ers, acting faithlessly in violation of their fiduciary roles, by forcing upon them securities, while identical in form, so radically altered in nature and substance, as to make them economic impostors.

62. The Series C and the Preferred are equity securities, just as are the Cashed Out Securities, but the Continental Directors, by authorizing the KMI-LBO Merger Agreement, and the KMI Corporations, aided and abetted by the KMI Directors, diverted or caused to be diverted, all or substantially all of the assets and credit jointly owned by all the equity securities, including the Classes, to the Cashed Out Securities, thereby eviscerating and evaporating the asset base which is the source of the right of the Classes to receive, and of Continental's obligation to pay, dividends, on which the members of each Class relied when they made their investments, and, as a consequence converted the long term, sound, quality, fixed return Series C and Preferred investments, into short term, hazardous speculations.

63. The Continental Directors, deliberately and wilfully aided by the KMI Corporations and the KMI Directors, deliberately and wilfully, breached their fiduciary duty to Plaintiffs and the members of both Classes, by burying the Series C and Preferred investments in the debt ridden, private KMI Continental, while paying the Cashed Out Securities premiums aggregating more than $850 million—as shown in the table on the following page.

64. The effect of the course of conduct of the Continental Directors, the KMI Corporations and of the KMI Directors, and of the specific acts herein alleged:

(1) Was and is to crush the intrinsic nature of the fixed income securities of a sound "A" rated public company, in which the members of both Classes invested, relegating them to securities less credit worthy than "junk bonds", in a highly leveraged, speculative, private company;

(2) Was and is in stark contrast to the generous premiums defendants gave the other shareholders, management

HOW THE CONTINENTAL SHAREHOLDERS FARED UNDER THE KMI-LBO

	Common Stock	*Series A*	*Series B*	*Series C*	*Preferred Stock*
Total No. of Shares Outstanding	42,622,297	6,220,741	243,630	1,583,845	50,624
Aggregate Cash—Out	$ 2.49 Billion	$181.96 Million	$10.69 Million	None	None
Total Redemption Cost	–	–	–	$84.81 Million	$ 5.57 Million
Merger Price Per Share	$ 58.50	$29.25	$43.875	–	–
Market Price, Per Share June 4,1984	$ 39.50	$22.00	$25.37*	$36.00	$ 32.00
Per Share Premium Over Market	$ 19.00(48%)	$ 7.25(32%)	$18.505(73%)	–	–
Aggregate Cash Premium Over Market	$809.82 Million	$45.10 Million	$ 4.50 Million	–	–
Redemption Price (1984)	–	–	–	$53.55	$110.00
Difference Between Redemption and Market Price—Per Share	–	–	–	$17.55	$ 78.00

* Representing price paid by Continental during 2d Quarter 1984 for 24,700 shares.

and employees, and the ultimate premium KMI took for itself—100% of Continental in five years, paid for by Continental.

65. The irreparable injury to Plaintiffs and the Classes was a predictable and inevitable consequence of said failure to exercise their responsibilities to Plaintiff and the Classes with scrupulous good faith.

66. By reason thereof, Plaintiffs and the members of each Class, have been irreparably injured and are entitled to the equitable relief herein prayed for.

67. Plaintiffs have no adequate remedy at law.

WHEREFORE, Plaintiffs demand judgment:

1. Declaring that the defendants, jointly and severally, have manipulated and depreciated the intrinsic nature of both securities, of their marketability, market prices and of the market therein, by their KMI-LBO Merger financing, and transforming the Series C and Preferred from quality, long term, fixed return, preferred investments in a sound public company, into speculative, low grade, inferior quality securities of a highly leveraged private company, to the irreparable injury of the owners thereof, in violation of Section 10(b) and Rule 10b-5, and thereby entitling them to mandatory injunctive relief compelling redemption of their securities.

2. Ordering and directing that defendants forthwith redeem all Series C Preference Shares and Preferred Shares, at their voluntary liquidation prices of $53.55 and $110 per share, respectively, with accrued dividends and interest from November 1, 1984; and to forthwith pay all members of both Classes who sold their shares after June 29, 1984—or who accepted payment upon the exercise of appraisal rights—the difference between the net amount received on sale or appraisal, and the redemption price.

3. Ordering and directing that, pending such redemption, the proceeds of any KMI Continental borrowings, sales or other dispositions of assets not in the ordinary course of

business, be impressed with a constructive trust in favor of Plaintiffs and the Classes in an amount equal to their redemption and interest entitlements.

4. Ordering and directing the Defendants to pay to Plaintiffs their reasonable attorney's fees, expert fees, and costs and disbursements of this action.

5. Ordering and directing such other and further relief as this Court may deem proper.

Dated: January 18, 1985
Hartford, Connecticut

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UNITED STATES DISTRICT COURT

DISTRICT OF CONNECTICUT

Civil Action No. B84-625 (EBB)

CHARLES S. CHRISTENSEN and JENNE CHRISTENSEN, Joint Tenants; ALTIE L. CLARK and LENA F. CLARK, Joint Tenants; JOHN C. ECHON, individually and as Joint Tenant with LILLIAN ECHON; JAMES M. HOSS, JR. and MARIAN C. HOSS, Joint Tenants; HENRY B. HOSS; DAVID C. KRISER; PENNSYLVANIA NATIONAL MUTUAL CASUALTY INSURANCE COMPANY,

Plaintiffs,

—against—

KIEWIT-MURDOCK INVESTMENT CORPORATION, PETER KIEWIT SONS, INC., PACIFIC HOLDING CORPORATION, KMI CONTINENTAL INC., THE CONTINENTAL GROUP, INC., S. BRUCE SMART, JR., DAVID H. MURDOCK, RAYMOND F. HENZE, III, WALTER SCOTT, JR., DONALD L. STURM, FLETCHER L. BYROM, DONALD J. DONAHUE, STEPHEN M. DUBRUL, JR., JACK S. PARKER, FRANK H. T. RHODES, DONALD V. SEIBERT, LUCY WILSON BENSON, COLBY H. CHANDLER, DON JOHNSTON, PETER G. PETERSON, and C. EDWARD ACKER,

Defendants.

PLAINTIFFS' MOTION FOR CLASS ACTION DETERMINATION

Pursuant to Rule 23(c)(1), Fed. R. Civ. P., Plaintiffs above named, hereby move the Court, as follows:

1. This action shall be maintained as a class action pursuant to Rules 23(a), 23(b)(1) and 23(b)(2), Fed. R. Civ. P.

2. The following classes shall be certified against all defendants herein:

(1) The beneficial owners, on June 29, 1984, and their successors (excluding defendants and their families), of the $4.50 Cumulative Preference Stock, Series C, of the Continental Group, Inc. ("Series C. Class").

(2) The beneficial owners on June 29, 1984, and their successors (excluding defendants and their families), of the $4.25 Cumulative Preferred Stock of the Continental Group, Inc. ("Preferred Class).

3. Plaintiffs Charles S. Christensen, Altie L. Clark, Lena F. Clark, John C. Echon, Lillian Echon, James M. Hoss, Jr., Marian C. Hoss, Henry B. Hoss, and Pennsylvania National Mutual Casualty Insurance Company, shall be designated as representatives of the Series C Class, and Plaintiff David C. Kriser as representative of the Preferred Class.

4. Counsel for plaintiffs, Schatz & Schatz, Ribicoff & Kotkin, and Tenzer, Greenblatt, Fallon & Kaplan, shall be designated as Counsel to each Class.

In support of this motion, plaintiffs state:

(1) Each Class is so numerous that joinder of all members is impracticable.

(2) The claims of the representative parties are typical of the claims of each Class.

(3) The representative parties will fairly and adequately protect the interests of each Class.

(4) The questions of law and fact common to the members of each Class predominate over any questions affecting only individual members.

(5) The prosecution of separate actions by individual members of each Class would create a risk of inconsistent and varying adjudications.

(6) A class action is superior to all other available methods for the fair and efficient adjudication of the controversy.

(7) The Defendants have acted on grounds generally applicable to both Classes, thereby making appropriate final equitable relief with respect to each Class as a whole, as prayed for in the Amended Complaint.

(8) The claims as they affect each entire Class, are best managed in one action, and can be adjudicated with dispatch in this district where the principal Defendants are located, and where many of the acts complained of originated or occurred.

Dated: January 18, 1985
Hartford, Connecticut

SCHATZ & SCHATZ, RIBICOFF & KOTKIN

By _____
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